법학박사 학위 논문

국제조세분쟁 해결 방법론으로서의 중재에 대한 연구

- OECD 가 제안한 상호합의 틀 내에서의 중재를 중심으로 -

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서울대학교 법학전문대학원

법학과 세법전공

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Study on Arbitration as Institution of International Tax Dispute Resolution

- Within the Ambit of Mutual Agreement Procedure as Suggested by the OECD -

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국문 초록

조세 분쟁을 해결하기 위한 방안 중 하나인 중재는 이전부터 존재하였던 것으로 조세조약과 비슷한 역사를 가지고 있다. 그러나 국가들은 협상을 기반으로 한 분쟁의 해결을 선호하였기 때문에 상호합의가 사실상 국제조세 분쟁의 유일한 해결 방안으로 사용되어 왔다. 상호합의는 훌륭한 국제조세 분쟁의 해결 방안이 되기도 하였으나, 과세관청과 납세자 사이의 이해관계의 대립으로 인한 내재적 한계를 지니고 있다. 이는 상호합의가 과세관청으로 하여금 납세자들의 이해관계를 대변할 것을 요구하기 때문이다. 납세자는 부당하게 과다한 세금을 납부하였음을 이유로 상호합의를 신청하는 것이 일반적인데, 그러한 과다한 세금을 부과한 과세관청이 오히려 상호합의의 당사자가 되어 납세자의 이해관계를 대변할 자격이 있는지에 대한 내재적 한계가 있을 수 밖에 없다. 또한 상호합의는 짧게는 2년에서 수년이 걸리므로 분쟁 해결에 소요되는 기간 동안 납세의무가 확정되지 않는다는 불확실성이 존재한다. 납세자들은 과세관청이 자신의 이해관계를 대변할 수 있을지에 대한 불신과 불확실성이 존재함에도 불구하고 상호합의를 선택할 수 밖에 없는 경우가 많았다.

OECD는 이러한 상호합의의 문제점을 해결하기 위한 방안으로 강제적인 중재 제도를 승인하고 OECD 모델 조세조약 제25조에 중재 조항을 삽입함으로써 조세조약의 발전을 도모했다. 이 논문은 실제로 조세 분쟁이 발생한 경우 과연 OECD가 승인한 중재 제도가 실효성이 있을지에 대하여 검토하였다.

OECD가 제안한 중재는 절차적인 측면에서 많은 지침을 제공하지만

다소 비효율적이고 중재 절차가 완료되기까지 2년 이상이 소요되며, 상호합의와 마찬가지로 납세자가 중재 절차에서 배제되는 반면 과세관청에게 많은 재량권이 있다는 문제가 있다. 이 논문은 중재의 개시 단계에서부터 중재인의 자격 및 선정, 중재의 형식, 중재의 결정 단계까지 각각의 중재 절차를 검토하여 개선할 수 있는 부분을 제시하였다. 특히 전체 중재에 소요되는 시간을 1년 미만으로 가능하도록 하여 각각의 절차에서의 비효율성을 최소화하는 방안을 제시하였다. 2년에 걸친 상호합의를 통하여 분쟁이 해결되지 않음에 따라 중재를 신청하였는데 추가적으로 2년 이상의 기간이 더 소요된다면 중재 제도를 도입한 본래의 취지가 훼손될 것이기 때문이다. 이런 측면에서 EU 이전가격 중재 조약 (EU Transfer Pricing Arbitration Convention)과 미국-독일간의 조세조약 (특히 2006년 Protocol에 삽입된 중재조항)은 OECD의 중재 조항에 대한 논의의 확장과 개선 방안을 제시하는데 있어서 유용한 참고자료가 되었다.

또한 이 논문은 OECD의 중재 모델의 절차적인 측면 외에 실체적인 측면에서도 검토하였다. 가장 중요한 것은 OECD가 제안한 중재는 강제적인 중재 (mandatory arbitration)로 표현되고 있으나 두 가지 관점에서 실제로 강제성이 있는지는 불분명하다. 첫째는 중재의 시작에 강제성이 있는지 여부이고, 둘째는 중재 결정이 납세자를 포함한 모든 당사자에게 구속력이 있는지에 대한 것이다. 납세자의 중재 신청이 중재 개시의 요건이라는 점에서 중재의 시작에 강제성이 없다는 문제가 있다. 이 논문은 EU 이전가격 중재 조약이나 미국-독일 조세조약과 같이 일단 상호합의가 2년내에 종결되지 않으면 자동적으로 중재에 회부 되는 것이 바람직하다고 제안하였다. 한편, 중재 결정의 효력과 관련하여 OECD가 제안한 중재는 근본적으로

상호합의의 틀 내에서만 가능하다는 문제가 있다. 중재 결정이 각 국가의 과세관청이 상호합의에 이르러야 비로소 효력이 발생하도록 규정되어 있어 진정한 의미의 중재라고 보기 어렵고, 오히려 또 다른 상호합의를 한 것에 불과한 것으로 볼 수 있기 때문이다. 진정한 의미의 중재의 핵심은 중재 결정이 각 나라에서 승인되고 집행이 가능함에 있다. 아마도 OECD가 중재를 상호합의의 틀 내에서 존재하는 것으로 한계를 지운 이유는 승인과 절차는 국내법의 문제이고, 현 중재 제도상 조세문제에 대한 중재 결정의 승인과 집행에 한계가 있을 뿐만 아니라, 각 국의 조세주권과도 관련되는 문제가 있어 현실적으로 상사중재와 같이 진정한 의미의 중재모델을 만들어 상호합의의 틀 밖으로 끌어내는 데는 현실 적인 문제가 있었을 것이다. 그럼에도 불구하고 중재 결정이 집행되지 않는 경우 납세자가 이를 승인하고 집행할 수 있는지에 대한 논의를 한국의 예를 들어 논의하였다.

주요어: 상호합의, 국제조세분쟁, 조세조약분쟁, 조세조약에 의한 중재, OECD 모델 조세조약 25조.

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CHAPTER 1. HISTORICAL BACKGROUND OF DISPUTE RESOLUTION PROVISIONS IN TAX TREATIES

I. Introduction

International trade and investments are ever-increasing as national borderlines no longer pose obstacles to global transactions in this era of globalization. Also on the rise along with cross border transactions are international tax disputes that intertwine taxpayers with sovereign authorities of the investor and investee countries. Despite the availability of administrative and legal remedies under domestic law of the concerned countries, international double taxation often remains even after exhaustion of domestic remedies. In order to help resolve international tax disputes, conventions on double taxation ("tax treaty", or "tax treaties" in plural) contain numerous agreements regarding the mutual agreement procedure (the "MAP") between or among the jurisdictional or competent revenue authorities of the concerned governments as well as exchange of information, or non-discrimination. However, not only do these mechanisms fail to provide a prompt and efficient dispute resolution method, they also have fundamental limitations when faced with the issue of allocation of taxing rights. Particularly, the fact that the MAP is regarded as the only practical solution to such international tax disputes poses a major issue; while the competent authorities have limited incentive to resolve the issues quickly and in favor of taxpayers, the MAP exacerbates the matter by limiting participation of the taxpayers in the dispute resolution process. The foregoing limitation has caused frustration among the taxpayers and often the competent authorities themselves.

In recognition of this limitation and frustration, in July of 2008, the Organization for Economic Co-operation and Development ("OECD") Council approved an update to the OECD Model Tax Convention on Income and on Capital (the "OECD Model Tax Convention" or the "Model Convention").[1] The 2008 update included a mandatory arbitration provision in Article 25, and the decision to include such provision was based on the report "Improving the Resolution of Tax Treaty Disputes" (the "OECD 2007 Report"), released in 2007 and adopted by the Committee on Fiscal Affairs.[2] Angel Gurria, the OECD Secretary General then, expressed at the Conference on the 50th Anniversary of the OECD Model Tax Convention that such mandatory arbitration would greatly improve the existing tax treaty dispute resolution mechanism.[3]

This was a significant development in the field of international tax dispute resolution where the MAP had so far been the only practical method of resolving international tax disputes. Compulsory adjudication by an independent third party other than the revenue authorities was suggested as a solution to international tax disputes as early as in 1895,[4] but it has been only in

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[1] On July 17th of 2008, the OECD Council approved the 2008 Update to the OECD Model Tax Convention. This followed the earlier approval of the update by the Committee on Fiscal Affairs at its meeting of June 24 and 25, 2008.

[2] Org. of Econ. Co-Operation & Dev. [OECD] Fiscal Affairs Comm., *Improving the Resolution of Tax Treaty Disputes*, (2007) (Report adopted by the OECD Committee on Fiscal Affairs (Jan. 30, 2007), *available at* http://www.oecd.org/dataoecd/ 17/59/38055311.pdf [hereinafter OECD 2007 Report].

[3] The Conference on the 50th Anniversary of the OECD Model Tax Convention was held on September 8, 2008 in Paris.

[4] Zvi Daniel Altman, *Dispute Resolution Under Tax Treaties*, 11 IBFD DOCTORAL SERIES, 2005, at 75.

the last 20 years or so that the arbitration movement has really gathered momentum. In fact, the OECD's adoption of the mandatory arbitration is the first global endorsement, and such endorsement seems timely, if not late, when the international trade and investments, as well as related international tax disputes involving taxpayers and government(s), are dramatically increasing in the midst of globalization. The United Nations followed the OECD and adopted arbitration in the 2011 update of the U.N. Model Tax Treaty, which was released in March of 2012.

As most countries have now adopted the OECD Model Tax Convention with country specific variations, the basic concept of the OECD Model Tax Convention is fairly well integrated in the existing treaties. When updates are made to the OECD Model Tax Convention, it is the discretion of each country whether and how to incorporate the OECD's recommendations into its own tax treaties. While many tax authorities, including the National Tax Service (the "NTS") of Korea, remain to be still skeptical about the benefits of international tax arbitration to certain extent, the global trend seems to observe the effect of tax arbitrations as more countries, including the U.S., Germany, Belgium and Canada, are incorporating arbitration related provisions in their tax treaties. For example, the Sweden and Germany agreed to allow international tax disputes to be resolved through arbitration as early as 1985.[5] The European Union has also

[5] Article 41, Paragraph 5, Sweden-Germany Germany - Sweden Income, Capital, Inheritance and Gift Tax Treaty (1992) which read as follows:

"5. The provisions of Chapters I, II and IV of the European Convention on the Peaceful Settlement of Disputes of 29 April 1957 shall be applied to settle international conflicts arising under this Convention. Notwithstanding the procedure provided therein, the Contracting States ***may agree****, however****, to submit a dispute to a court of arbitration****, whose decision shall be binding. Such court of arbitration shall be composed of professional judges of the Contracting States, third States or international organizations. Its proceedings shall follow internationally recognized principles. The persons concerned in the case shall have*

implemented arbitration of tax treaty disputes for transfer pricing issues through the EU Transfer Pricing Arbitration Convention in 1990. In June 2006, United States renegotiated the treaties with Germany and Belgium, and the arbitration provision became mandatory in December 2007 for these treaties by executing protocols, followed by the same modifications made to the U.S. - Canada shortly thereafter.[6]

In Korea, neither the National Tax Service nor the Ministry of Strategy and Finance has commented on the OECD's adoption of the arbitration provision in the OECD Model Tax Convention. None of the Korea's tax treaties has an arbitration clause as yet. However, there was a notable event recently during the re-negotiation of the tax treaty between Korea and Switzerland. One of the matters that were included in the agenda for re-negotiation was whether to adopt or require arbitration in the tax treaty as a way to resolve tax treaty disputes. Korea was not ready and the two countries compromised, at this time, and agreed to negotiate again when and if Korea enters into a tax treaty containing arbitration provision with any other countries in the future. Accordingly, the two countries agreed as follows in the Protocol[7] signed in

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the full right to be heard and to submit their own requests. The decision of the court shall be made on the basis of the provisions of agreements in force between both Contracting States and of the general international law; a decision ex aequo et bono shall not be allowed. As long as no agreement has been reached to resort to a court of arbitration and on its composition and procedures, each Contracting State may proceed in accordance with the first sentence."

[6] The U.S. modified the treaties with Germany, Belgium and Canada through protocols to implement a mandatory arbitration in the respective treaties. The protocols were signed in 2006 for Belgium and Germany and came into force in December 2007. *See* IRS website article *available at* http://www.irs.gov/businesses/international/article/0,,id=181003,00.html (last visited June 4, 2012).

[7] Protocol Amending the Convention Between Switzerland and the Republic of Korea for the Avoidance of Double Taxation with Respect to Taxes on Income, Article XIV, Para. 1, Signed at Berne on February 12, 1980.

2011 and became effective on July 25, 2012:

> *If at any time after the date of signature of this Protocol, Korea includes a provision on arbitration in any of its double taxation conventions, Korea shall inform Switzerland in writing and shall enter into negotiations with Switzerland with a view to including a provision on arbitration in the present Convention for the avoidance of double taxation with respect to taxes on income.*

Given the foregoing situation in Korea and around the globe, this paper raised a fundamental question as to whether the arbitration system as recommended by the OECD is workable. As a process of finding an answer to this question:

Chapter 1 will discuss the historical background of evolution of tax treaties as it relates to the evolution of methods of resolving disputes arising out of tax treaties, which will reveal that arbitration has been considered as one of the international tax dispute resolution methods since early years, but it was the governments themselves that preferred negotiation based resolution of tax treaty disputes, which was eventually codified as a MAP in tax treaties.

Chapter 2 is devoted to the analysis and discussion of the MAP in general, focusing in particular on different interests of the parties involved, and will show that the MAP arguably is an ill-designed system for resolving international tax disputes due to the fact that the underlying interests of business community and the sovereign governments are inherently irreconcilable, as taxpayers and tax collectors, respectively, and that the competent authority may not be a qualified representative for taxpayers in MAPs. This analysis is

accompanied by empirical evidences, albeit very limited due to the non-transparent nature of the MAP, which corroborates under-utilization of MAP. The chapter then proceeds to an analysis of alternative ideas for dispute resolution other than the MAP.

Chapter 3 will present an overall legal framework for analyzing tax treaty arbitrations. Part II discusses the development of arbitration in commercial and governmental disputes and how tax treaty arbitration fits into the broader context of international commercial arbitration. Based on this framework, Part III reviews and analyzes the EU Transfer Pricing Arbitration Convention, which is the only existing tax arbitration convention. Though its application is confined to transfer pricing cases, it provides considerable guidance on what needs to be addressed in tax arbitrations and how its tenets can be applied for improving the current OECD tax arbitration. One of the most important elements of the EU Transfer Pricing Arbitration Convention is that it allows taxpayers to participate in the arbitration proceeding and it requires the outcome of the arbitration to be binding on all parties as long as the outcome eliminates double taxation. Part IV, then, introduces three investment arbitration cases involving tax disputes. Though they are not tax treaty cases, they nevertheless demonstrate the procedures how arbitrations actually resolved tax disputes, and will help find the specific issues for designing arbitration mechanism by a tax treaty.

Chapter 4 advances to in-depth analyses and critique of the new mandatory arbitration provision of the OECD Model Tax Convention in detail. Specifically, Part II analyzes major substantive issues including (a) whether the arbitration provision proposed by the OECD is a ‘mandatory’ and ‘binding’

arbitration as it claims to be; (b) how the arbitration process will interact with the domestic remedies and with the MAP itself; and (c) what the status of taxpayers is. Part III analyzes procedural matters. Included in such analysis in Parts II and III are possible improvements to the OECD's arbitration clause and the Sample Arbitration Agreement, by comparing specific provisions of the OECD Model Treaty with those of the U.S.-Germany Tax Treaty and the EU Transfer Pricing Arbitration Convention, so as to make the arbitration system more self-operational and self-sustaining. This chapter further discusses that the arbitration system as proposed by the OECD may not lead to a final resolution of a case because the arbitration, as envisaged by the OECD, is confined to the boundary of MAP, which does not have a mechanism for recognition and enforcement of an arbitral decision. Accordingly, it seems that OECD tax arbitration is an arbitration procedurally, but not so substantively.

Chapter 5 discusses the recognition and enforcement of arbitral decision so that the tax arbitration can be considered to be an arbitration both procedurally and substantively. Recognition or enforcement of an arbitral decision becomes a difficult concept when the parties to arbitration are the two governments with taxpayers, not parties to arbitration, who has financial stake in the outcome of the arbitration. Because the recognition and enforcement issues are country-specific, i.e., they can be analyzed only in the context of a particular national law, the analysis in Chapter 5 is confined to the legal system of Korea. With a brief introduction of the Korean tax and legal system, it is discussed that it would be possible to revise the relevant tax laws so that arbitral decision can be a basis for taxpayers to request the Korean tax authority to accept the arbitral decision. However, in case such tax laws are not promulgated, and further, the other treaty partner country lacks the similar or equivalent provisions in their

own tax laws, it may be necessary to design a mechanism under which an arbitral decision is recognized and enforced under the domestic laws. It is analyzed whether an arbitral decision can be rendered in a form that could be acceptable in Korea without encroaching upon the sovereignty and cautiously concludes that it may be possible to have the arbitral panel render a decision that cancels the tax assessment, which though not enforceable per se in Korea, but can be recognized in accordance with the domestic law to permit further legal actions for enforcement.

II. Evolution of Tax Treaties in Relation to Dispute Resolution Provision

A. Cross-Border Business Activities and Double Taxation

When a person derives income from cross-border transactions or properties with cross-border characteristics, there are two ways to assess a tax on such person; (1) to tax income based on the residency of the person who earned such income or owned such property ("resident based taxation"); and (2) to tax income earned or located within a state regardless of who the person is ("source based taxation"). Under the "resident based taxation" system, if the person who earned the income is a resident of a country, the country will have a right to tax all income earned by the taxpayer regardless where the income was earned.

In many countries residents are taxed on their worldwide income while non-residents are only taxed on domestic source income. This statement of course is an over-simplification in that countries do have a varied form of tax jurisdictions. For example, the Netherlands have a dual system that does not tax

dividend or capital gain income upon satisfaction of certain conditions; this is called the "participation exemption," i.e., income from participation, meaning equity investment in stock, is exempted from taxes.[8] It was recognized early on that the two bases for taxation raised the possibility of double taxation of foreign source income. Double taxation, in fact, already became an issue in early 1920s when governments were pressured to collect revenue for restoring their war-torn economies after World War I[9] and a few countries gathered together to discuss how such double taxation can be alleviated.

Double taxation was regarded as extremely detrimental to the development of international trade and the prosperity of nations.[10] Therefore, as will be discussed below, States began to make efforts to minimize or eliminate it by entering into bilateral tax treaties, under which they allocated their taxing rights and agreed on what is to be taxed, whether wholly or partially, respectively in the resident state and in the source state; the first of such tax treaty was entered into as early as in 1899 between Austria and Prussia.[11] Various international institutions, such as the International Chamber of Commerce ("ICC"), the United Nations ("U.N.", formerly the League of Nations until the end of World War II), and the Organisation for Economic Cooperation and Development

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[8] IBFD Tax Research Platform, Netherlands, Corporate Taxation, http://online.ibfd.org/kbase/#topic=doc&url=%252Fcollections%252Fcta%252Fhtml%252Fcta_nl_s_006.html&WT.z_nav=outline&colid=4916&hash=cta_nl_s_6.1.3.

[9] Altman, *supra* note 4, at 37.

[10] *See* JOHN G. HERNDON, JR., *Relief From International Income Taxation*, *in* THE DEVELOPMENT OF INTERNATIONAL RECIPROCITY FOR THE PREVENTION OF DOUBLE INCOME TAXATION 261-62, at 30 (1932). (providing that double taxation "paralyses" the development of international trade and the prosperity of nations); *see also* CHARLES R. IRISH, *Private and Public Dispute Resolution in International Taxation*, 4(2) Contemp. Asia. Arb. J. 121, 2011, *available at* http://ssrn.com/abstract=1966425 (". . . double taxation of international income flows would kill off a great amount of international business and investment . . . .").

[11] *See infra* Ch.1, Part B for Austria – Prussia Treaty.

("OECD"), also began to collaborate to resolve the double taxation issues in the early 20th century, as will be discussed in detail in Sub-Section C.[12] Such efforts led to the issuance of model income tax treaty by the League Nations as well as the OECD in subsequent years. In fact, the OECD Model Tax Convention has been the basis for almost all treaties that the States has entered into since the 1960s. Notwithstanding such various efforts, however, the issue of double taxation still remains uncured because much of the interpretations of income tax treaties were left to individual states, tax authorities, and national courts. When the contracting states have differing interpretations on certain tax treaty provisions, the divergent views often result in greater taxpayer burdens and international double taxation that distorts cross border economic activities.[13]

The differing views of the States and international organizations played a role in the evolution of tax treaties, particularly the MAP provisions therein. States have preferred inter-governmental negotiations instead of involving international authorities with respect to the resolution of disputes arising out of tax treaties. International organizations, on the other hand, have suggested in the early years that conflicts arising from a treaty between the States be resolved through international institutions that are authorized to arbitrate, mediate or provide advisory opinions. The States' preference for negotiations has led to the development of the MAP, and it eventually led to international organizations' aligning themselves with the States in terms of dispute resolution method; they adopted MAP provisions in their reports and model tax

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[12] *See infra* Ch.1, Part C.

[13] William W. Park, *Tax Council Policy Institute Symposium: The Future of International Transfer Pricing: Practical and Policy Opportunities: Income Tax Treaty Arbitration*, 10 GEO. MASON.L. REV. 803, 807 (2002).

conventions. It should, however, be noted that international institutions regarded arbitration as one of the methods of international dispute resolution. This history well demonstrates that arbitration of international tax disputes, though may have never been widely accepted or utilized, is not a new concept.

Discussed in detail in the following section is the evolution of tax treaties as well as the dispute resolution provisions contained therein.

B. Dispute Resolution & Early History of Tax Treaties

1. 1899 Tax Treaty between Austria and Prussia

The history of income tax treaty goes as far back as the 1890s when Austria and Prussia signed a bilateral treaty in June 1899 for the prevention of double income taxation.[14] This first income tax treaty provided that the two States would take appropriate actions to resolve any disputes pursuant to the mutual understanding that they agree on. The relevant provision did not specify the exact steps to be taken, but it seems to have suggested that the two governments shall collaborate together to resolve the matter.[15] It did not explicitly provide that such collaboration was mandatory or binding, but seems to have left it to

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[14] Michelle S. Bertolini and Pamela Q. Weaver, *Mandatory Arbitration within Tax Treaties: A Need for a Coherent International Standard*, at 3, *available at* http://aaahq.org/ata/meetings/midyear-meetings/2012/2012%20JLTR%20Bertolini%20Weaver.pdf.

[15] *See* Altman, *supra* note 4, at 13 (Article 7 of the 1899 treaty is translated to read "Concerning the potentially required special provisions for the appropriate elimination of double taxation of such persons who are Austrian as well as Prussian nationals and, at the same time have their residence in both territories, the Contracting Parties will enter into an understanding and will take appropriate measures in accordance with this understanding.")

the discretion of the States. This can be seen as the historical origin of the current MAP process.

2. Subsequent Treaties until the end of World War II

The Austria-Prussia bilateral treaty served as a model income tax convention for subsequent treaties of that time.[16] By 1945, 80 income tax treaties were entered into by various States.[17] For almost all treaties at that time, dispute resolution process was based on negotiations between the two governments though there were differences as to the type and level of the government bodies that were involved in the process.[18] However, there were two treaties that included dispute resolution methods that were somewhat different; one is the 1922 Multilateral Treaty of Rome and the other the 1926 U.K.-Irish Free State Income Tax Treaty.

a. The 1922 Multilateral Treaty

The 1922 Multilateral Treaty was signed by Italy, Hungary, Poland, Romania, and Yugoslavia. Though this treaty was never implemented, the dispute

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[16] *Id.*, at 195.

[17] Research found 90 income tax treaties that have effective date between 1900 and 1946. Excluding those that were entered into as a protocol or as an amendment to the original agreement, the actual number of income tax treaties was 77. There are 26 Estates and Gift tax treaties that had an effective date before 1946, four of which are still in force. Research was conducted on Tax Analysts, *Worldwide Tax Treaties*, 2012.

[18] Altman, *supra* note 4, at 14.

resolution provision contained therein is worth noting.[19] Article 10 of the 1922 Treaty of Rome provided:

> *If it is proved that the action of the financial authorities of the different States has resulted in the levying of double taxation on the taxpayer, the latter may appeal to the State to which he belongs. If his appeal is allowed, the Sate in question may, in the interest of the taxpayer, demand through diplomatic channels that the financial authorities of the States which have levied the taxation in question shall agree on some equitable arrangement for avoiding double taxation.*

This particular provision of the 1922 Multilateral Treaty contained a two-tier procedure, under which the taxpayer would first appeal to the tax authority of the resident country. If his appeal was found to be justified, then the tax authority of the resident country was allowed to contact the tax authority of the other country (generally the sourcing state) for an equitable arrangement to resolve the taxpayer's issue.[20]

Such two-tier system demonstrates a striking similarity to today's MAP process, under which the taxpayer brings the issue to the competent authority of one country, and such competent authority, should it determines that the taxpayer's

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[19] Bertolini and Weaver, *supra* note 14, at 4 (providing that the 1922 multilateral treaty, though was never implemented, was the first treaty to "enhance the MAP provisions over and above the standard agreement . . . ."); *see also,* Herndon, *supra* note 10, at 261-62.

[20] Convention for the Purpose of Avoiding Double Taxation, Austria-Hung.-It.-Pol.-Rom.-the Kingdom of the Serbs Croats and Slovenes, Art. 7, Apr. 6, 1922, League of Nations Doc. C.345.M.102 1928, II, at 73.

case has a merit, contacts the competent authority of the other country for settlement of the issue. The existence of this provision in the 1922 Multilateral Treaty is of quite significance considering that the treaties of that time lacked such formal procedures for the purpose of making an appeal to a fiscal authority.

b. The 1926 Income Tax Treaty between the U.K. and Ireland

The 1926 Income Tax Treaty between the U.K. and the Irish Free State ("1926 U.K.-Ireland Tax Treaty") is also noteworthy in terms of its dispute resolution provision. Article 7 of 1926 U.K.-Ireland Tax Treaty provides:

> *Any question that may arise between the Parties to this Agreement as to the interpretation of this Agreement or as to any matter arising out of or incidental to the Agreement shall be determined by such tribunal as may be agreed between them and the determination of such tribunal shall, as between them, be final.*

This dispute resolution process is more similar to the mandatory arbitration process found in the current OECD Model Tax Convention in a way that all dispute is to be determined by a tribunal of the States' choice, whose determination is binding and final.

C. Efforts by International Institutions

1. International Chamber of Commerce

Until the end of World War I, income tax rates on international transactions were sufficiently low that tax did not pose a serious obstacle to international trade.[21] However, after World War I, States were pressured to raise revenue for restoring their war-torn economies and the income tax rates started to go up. As a result, double taxation became much more serious issue for business entities.

The earliest organization response to double taxation came from the International Chamber of Commerce ("ICC") in 1920 when the ICC appointed an International Committee on Double Taxation with representatives from six nations.[22] The International Committee on Double Taxation came up with 15 proposals, which were submitted to the Rome Congress for adoption in December of 1922. Out of the 15 proposals, the 15th proposal addressed a dispute resolution as follows:

> *Should an argument arise between a tax-payer and any country with regard to the application of the above principles, the tax-payer should be able to appeal to an international organization which is to be created. The appeal should not be heard until the taxes due to the different States had been actually levied and paid. The appeal would have to be based on the grounds that the principle embodied in the foregoing formulae had not been observed. The international organization would be divided into administrative and legal section.*

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[21] Michael J. Graetz and Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation*, 46 DUKE L.J. 1021, 1045 (1997); Altman, *supra* note 4, at 195.

[22] *See* Resolution 11 in Herndon, *supra* note 10, at 20-21 (providing that the participating countries were Belgium, France, the United Kingdom, Italy, the Netherlands, and the United States).

The proposal suggested a creation of an international organization to help resolve tax disputes. Again, this "international organization" which was to be given the authority to hear cases and make determination was equivalent to an arbitral tribunal. The U.S. and the U.K., however, rejected the 15th dispute resolution proposal.[23]

2. The League of Nations

a. Report by the Committee of Economic Experts

Separate from the work conducted by the ICC, in the 1920's the League of Nations commissioned several studies on international double taxation and how to alleviate it. As part of such commission, the League of Nations[24] established a committee of four economic experts and entrusted it with the task of studying double taxation and coming up with recommendations. This committee, called the Committee of Economic Experts, published its report in 1923, but it contained no discussion on dispute resolution.

b. Reports by the Committee of Technical Experts

In addition to the Committee of Economic Experts, the League of Nations formed the Committee of Technical Experts to study the question of tax evasion in conjunction with the issue of double taxation. Seven countries participated

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[23] Altman, *supra* note 4, at 38 n.164.

[24] The League of Nations was created in 1919 as a result of the Paris Peace Conference which ended the World War I. The League of Nations was replaced by the United Nations in late 1920s.

in the Committee of Technical Experts.[25] The reports by the Committee discussed dispute resolution and the need for an international organization which was consistent with the suggestion of the ICC from earlier years. (See *supra* discussion on the ICC). In its report, the Committee of Technical Experts clarified that the scope of such international organization would have advisory powers assisting governments in settling their disputes.

c. The 1927 Report

The Committee of Technical Experts on Double Taxation and Tax Evasion was expanded to include 13 countries[26] in 1925 and this expanded Committee submitted a report to the Council and to the Members of the League in April of 1927. The 1927 report was comprised of five parts; four draft conventions[27] and the last part with various proposals regarding future organization. The draft income tax treaty included a dispute resolution provision in Article 14, which provided:

> *Should a dispute arise between the Contracting States as to the interpretation or application of the provisions of the present Convention, and should such dispute not be settled either directly between the States or by the employment of any other means of*

[25] The seven Countries are Belgium, Czechoslovakia, France, Italy, the Netherlands, the U.K. and Switzerland.

[26] The members of the Committee of Technical Experts on Double Taxation and Tax Evasion included Argentina, Belgium, Czechoslovakia, France, Germany, Great Britain, Italy, Japan, the Netherlands, Poland, Switzerland, U.S., and Venezuela.

[27] The Committee of Technical Experts drafted 4 conventions: (1) convention for the prevention of double taxation; (2) convention for the prevention of double taxation in the special matter of succession duties; (3) convention on administrative assistance in matters of taxation; and (4) convention on judicial assistance in the collection of taxes.

reaching agreement, the dispute may be submitted, with a view to an amicable settlement, to such technical body as the Council of the League of Nations may appoint for this purpose This body will give an advisory opinion after hearing the parties and arranging a meeting between them if necessary.

The Contracting Sates may agree, prior to the opening of such procedure, to regard the advisory opinion given by the said body as final. In the absence of such an agreement, the opinion shall not be binding upon the Contracting States unless it is accepted by both, and they shall be free, after resort to such procedure or in lieu thereof, to have recourse to any arbitral or judicial procedure which they may select, including reference to the Permanent Court of International Justice as regards any matters which are within the competence of that Court under its Statute.

Neither the opening of the procedure before the body referred to above nor the opinion which it delivers shall in any case involve the suspension of the measures complained of; the same rule shall apply in the event of proceedings being taken before the Permanent Court of International Justice, unless the Court decides otherwise under Article 41 of its Statute.

Basically, Article 14 of the 1927 draft income tax treaty adopted a non-compulsory procedure under which an independent technical body would hear the case and provide an advisory opinion, to which the two States may agree to be bound by, with an option to be heard at the Permanent Court of International

Justice. Also, in the last part of the 1927 report, the Committee suggested to "draw up a procedure of conciliation and arbitration." This suggestion demonstrates that the possibility of having an arbitration procedure for treaty disputes was considered as early as in the 1920s. The report also proposed the establishment of a standing committee as part of the League organization.[28]

d. Draft Treaties in 1928

In October 1928, the draft model income tax treaties were adopted by the General Meeting of Government Experts on Double Taxation and Tax Evasion.[29] There were three versions of the income tax treaty,[30] and all three versions provided the framework for the negotiation of a network of treaties through the same dispute resolution provision found in the 1927 draft income tax treaty.

e. Draft Plurilateral Treaty in 1931

The League of Nations created a new committed called the "Fiscal Committee", which is to continue the study of double taxation after the Committees of Technical Experts issued the 1927 report and draft model income tax treaties.[31]

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[28] *Reports presented by the Comm. Of Technical Experts on Double Taxation and Tax Evasion*, League of Nations Doc. C.216M.85 1927 II, at 31, (1927) [hereinafter League of Nations 1927 Report].

[29] *Reports adopted by the Gen. Meeting of Gov't Experts on Double Taxation and Tax Evasion*, League of Nations Doc. C.562.M.178 1928II, at 31, (1928) [hereinafter League of Nations 1928 Report].

[30] Altman, *supra* note 4, at 46.

[31] *See* Plurilateral Convention for the Prevention of the Double Taxation of Certain Categories of Income, in "League of Nations, Fiscal Committee, Report to the Council on the Work of the

The new Fiscal Committee published draft plurilateral income tax conventions for the prevention of double taxation, but the plurilateral initiative eventually failed due to lack support from member countries.[32]

f. 1945 London draft treaties

In 1943, the Fiscal Committee of the League of Nations drafted a new model bilateral tax treaty for the prevention of double income taxation, followed by another version in 1946.[33] It is the Mexico Model Treaty that adopted the MAP for the first time. Article 16 of the Mexico Model Treaty (and Article 17 of the London Model Treaty) reads:

> *1. When a taxpayer shows proof that the action of the tax administration of one of the contracting States has resulted in double taxation, he shall be entitled to lodge a claim with the tax administration of the State in which he has his fiscal domicile or of which he is a national.*
>
> *2. Should the claim be admitted, the competent tax administration of that State shall consult directly with the competent authority of the other State, with a view to reaching an agreement for an equitable avoidance of double taxation.*

Third Session of the Committee", League of Nations Doc. C.415.M.171.1931 II A (Geneva, 6 June 1931).

[32] Altman, *supra* note 4, at 49.

[33] The Fiscal Committee met in Mexico in 1943 and then in London in 1946. The drafts of the model treaty were called the "Mexico Model Treaty" and the "London Model Treaty," respectively.

There is no clear explanation as to why the dispute resolution provisions shifted from resorting to technical bodies and international organizations to facilitating mutual agreement between the competent authorities of the States. This was probably an inevitable reflection of the reality that the States were entering into bilateral income tax treaties with dispute resolution procedures of the character of negotiations between the States.[34] In this regard, Altman claims that the States at that time did not trust the international courts[35] including the Permanent Court of International Justice, and the States were not willing to accept the dispute resolution procedure as suggested in the earlier draft model conventions. Since this new model bilateral tax treaty was drafted, all major model income tax conventions included a MAP provision without any reference to international groups of experts, international courts, arbitration, and etc.[36]

g. From League of Nations to United Nations

The League of Nations ceased its activities after failing to prevent the World War II. Upon the end of the World War II in 1945, the United Nations ("UN") came into being in October of the same year with more than 50 countries signing the United Nations Charter. In the following year, the Economic and Social Council of the UN set up the Fiscal Commission which was requested to "study and advise the Council in the field of public finance, particularly in its legal, administrative and technical aspects." After the Fiscal Commission and

[34] *See Supra* Ch.1, Part II, Sec. B for the details on what the States actually agreed to in the early income tax treaties.
[35] Altman, *supra* note 4, at 56.
[36] *Id.* at 55-56.

its Committee on International Tax Relations stopped functioning in 1954, the focus of action in the field of international taxation was shifted to the OEEC.[37]

D. Efforts by OECD

1. 1963 Draft OECD Model Income Tax Convention

It was not until 1955 that the Council of OEEC[38] paid attention to the issue of double taxation upon the world business community's expressing its concern that the existing double tax treaties failed to afford full protection against double taxation. In response to such concern, the OEEC Fiscal Committee was established in March 1956. From 1958 to 1961, the Fiscal Committee prepared four reports, entitled "The elimination of double taxation" in which the Committee proposed a total of 25 Articles. After the OEEC became the OECD in September 1961, the Fiscal Committee agreed on a number of new Articles and included all of them in a report titled "Draft Double Taxation Convention on Income and on Capital" published in 1963 ("1963 OECD Model Tax Convention").[39] Article 25 of the 1963 OECD Model Tax Convention provided:

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[37] U.N. Dep't of Econ. & Soc. Affairs, U.N. Model Double Taxation Convention between Developed and Developing Countries, Introduction, para. 26 at xvii, ST/ESA/PAD/SER.E/21, U.N. (2001) [hereinafter U.N. Model Convention].

[38] The Organization for European Economic Co-operation (OEEC) came into being on 16 April 1948 to help administer the Marshall Plan for the reconstruction of Europe after World War II. Later, and its membership was extended to non-European states. In 1961, it was reformed into the OECD, a worldwide body. In 1961, the OECD consisted of the European founder countries of the OEEC plus the United States and Canada. The list of member countries has expanded over the years to 34 countries today. Its purpose is to stimulate economic progress and world trade.

[39] Then, in 1966, the "Draft Convention for the Avoidance of Double Taxation with Respect to Taxes on Estates and Inheritances" was published.

Article 25 MUTUAL AGREEMENT PROCEDURE

1. Where a resident of a Contracting State considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with this Convention, he may, notwithstanding the remedies provided by the national laws of those States, present his case to the competent authority of the Contracting State of which he is a resident.

2. The competent authority shall endeavor, if the objection appears to it to be justified and if it is not itself able to arrive at an appropriate 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 not in accordance with the Convention.

3. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs. When it seems advisable in order to reach agreement to have an oral exchange of opinions, such exchange may take place through a Commission consisting of representatives of the competent authorities of the Contracting States.

This provision is found in most of the income tax treaties in force today. Though there is no mention of arbitration in the text, the Commentary to Article

25 notes the possibility to call upon the Fiscal Committee to give an opinion where special difficulties of interpretation arise on a certain provision.[40] Therefore, it seems that the idea of having an international institution or international arbitration was continued into the work of the OECD for the purpose of uniformity in the application and interpretation of the treaties.

By this time, the Council of the OECD started to recommend the member countries to conclude bilateral tax conventions on income and capital, based on the OECD Model Tax Convention and the Commentaries thereon, when they enter into treaties with other member countries, and if appropriate with non-member countries, to revise the existing conventions that may no longer reflect present-day needs.[41] As a result, the OECD Model Tax Convention began to be used widely by OECD member countries as well as non-member countries.
Today, the OECD Model Tax Convention and its Commentary has grown in importance and utilization around the world that the negotiations of bilateral tax treaties among the member and non-member countries and the interpretations thereof are often based on the OECD Model Tax Convention and its Commentary.[42]

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[40] *See* Altman, *supra* note 4, at 58 (providing that "[a]lthough the dispute resolution provisions of Art. 25 under the 1958-1961 OEEC Model Income Tax Convention and subsequently the dispute resolution provisions found in Art. 25 of the 1963, 1977, and 2000 OECD Model Tax Conventions did include some very important changes over time, the general procedure remained basically the same MAP we find in most of the income tax treaties that are in force today. . . .").

[41] U.N. Model Convention, *supra* note 37, para. 31.

[42] OECD, *Committee on Fiscal Affairs, Model Double Taxation Convention on Income and Capital* (2000), *Report by the Committee on Fiscal Affairs*, Part B. Paras. 12-15 (providing that countries, including Member and non-Member states, have been using the OECD Model Conventions as the bases of their negotiations, and there is a growing use of the Commentaries for the interpretation of tax treaties).

2. 1977 OECD Model Tax Convention

A revision of the 1963 "Draft Convention" ultimately led to the publication of the 1977 Model Double Taxation Convention on Income and on Capital ("1977 OECD Model Tax Convention"). Article 25 of the 1977 OECD Model Tax Convention was revised slightly as follows: [Newly added parts are underlined]

> *Article 25 MUTUAL AGREEMENT PROCEDURE*
>
> *1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident <u>or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention</u>.*
>
> *2. The competent authority shall endeavor, if the objection appears to it 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. <u>Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.</u>*

> *3. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.*
>
> *4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs. When it seems advisable in order to reach agreement to have an oral exchange of opinions, such exchange may take place through a Commission consisting of representatives of the competent authorities of the Contracting States.*

Again, neither the fundamental two-step process of the MAP nor the substantive language changed in comparison to the 1963 version. The 1977 version clarified the scope of the MAP in the following respects:

- The MAP is accessible by nationals (yet not residents) of the Contracting State;
- Three year limitation to invoke the MAP; and
- Decisions reached under the MAP are not subject to domestic statutes of limitation.

The Commentary to Article 25 of the 1977 OECD Model Tax Convention noted more specifically the need for an international organization or an independent

arbitrator to provide advisory opinions for purposes of achieving uniformity in the application of the provisions.[43]

3. 1984 Reports of the Committee on Fiscal Affairs

The Committee on Fiscal Affairs worked on issues pertinent to transfer pricing and the assessment of taxable profits of associated enterprises in general, which led to the Report on Transfer Pricing, Corresponding Adjustments and the Mutual Agreement Procedure ("1984 Report").[44] The 1984 Report acknowledged the dissatisfaction of a MAP by multinational enterprises, and studied the possibility of mandatory corresponding adjustments subject to arbitration[45] and many important advantages thereof, as suggested by the business community.[46] However, the 1984 Report, in its conclusion, recommended against the binding arbitration for a number of reasons. The first reason was that a mechanism that was merely an extension of the mutual agreement procedure in nature would not function sufficiently and properly as a binding arbitration procedure. Other reasons included such issues as (1) how to deal with the taxpayer's rights of appeal to his own domestic courts; (2)

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[43] Org. of Econ. Co-Operation & Dev. [OECD], OECD Model Double Taxation Convention on Income and Capital (1977), Commentary to Article 25.

[44] There were three reports on Transfer Pricing and Multinational Enterprises: (1) Transfer Pricing, Corresponding Adjustments and the Mutual Agreement Procedure; (2) The Taxation of Multinational Banking Enterprises; and (3) The Allocation of Central Management and Service Costs. These were all published in one volume.

[45] Org. for Econ. Co-Operation & Dev. [OECD] Comm. on Fiscal Affairs, *Transfer Pricing and Multinational Enterprises: Three Taxation Issues*, at 20 (1984) [hereinafter OECD 1984 Report].

[46] Some of the advantages of a binding arbitration cited by the 1984 Report include, inter alia, certainty of a decision and the reduction of delay in bringing the problem before a deciding authority; the ability to deal with the issue more effectively when the information is fresh; expeditious proceeding; and the opportunity for the taxpayer to represent itself. The benefits of a binding arbitration are discussed in detail later on in this paper below in Chapter 3.

whether the arbitration should be final; (3) what the object of the arbitrators should be; (4) how to deal with a situation in which double taxation was not the issue; and (5) the approach the arbitrators should adopt.[47]

However, the reasons the OECD listed above for rejecting a binding arbitration system are not convincing in that they relate to merely procedural issues which should be addressed after a substantive review vindicates adoption of the new mechanism. In other words, the binding arbitration system, as a whole, was rejected just because of the procedural complication without adequately reviewing many substantive merits as a dispute resolution mechanism. Furthermore, it is ironic that the OECD, while it evaluated a mere extension of the MAP would not be sufficient, eventually adopted the binding arbitration in 2008 as an extension of the MAP.

4. 2004 Report on Improving the Process for Resolving International Tax Disputes

Despite the OECD's endorsement of the MAP, the business community continued to express concern on its effectiveness. Hence, the OECD undertook a project by creating a joint working group that produced the 2004 Report. The 2004 Report's discussion was comprised of two parts: (1) improving the effectiveness of the MAP process; and (2) other supplementary dispute resolution techniques. The first part led to the Manual for the Effective Mutual Agreement Proceedings ("MEMAP"),[48] and the second part introduced possible forms of supplementary dispute resolution including arbitration. The

[47] OECD 1984 Report, *supra* note 45, at 21-25.
[48] *See infra* Ch. 2, Part II, Sec. F for further discussion on the MEMAP.

2004 Report proposed to examine the feasibility of implementing the mandatory submission of unresolved MAP cases to a form of supplementary dispute resolution, mainly a mandatory arbitration, and introduced the details of the related work done by the International Fiscal Association and the ICC in the Annexes. This is an interesting shift in the stance of the OECD given its prior position that a mandatory arbitration could not be considered a possible solution.

5. 2007 Report on Improving the Resolution of Tax Treaty Disputes

Then, the proposed work was followed up and the OECD came up with the report in 2007, which introduced the mandatory arbitration mechanism and the relevant language to be implemented in the OECD Model Tax Language.[49]

6. 2008 Draft OECD Model Income Tax Convention

In 2008, the OECD adopted the 2007 Report and implemented the mandatory arbitration in Article 25 as part of the MAP provision.[50]

E. The United Nations Follows the OECD Model Tax Convention

In the mid-1960s, as a result of the increasing number of developing member States who expressed their concern that the 1963 OECD tax convention did not suit their needs, the United Nations began to take a renewed interest in the

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[49] OECD 2007 Report, *supra* note 2, n.2.
[50] *See infra* Ch. 4 for analysis on Article 25, Paragraph 5 of the OECD Model Tax Convention, which is the mandatory arbitration provision.

problem of double taxation.[51] In 1967, the Economic and Social Council of the United Nations established the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries.[52] The OECD Model Tax Convention was chosen to be the basis for the U.N. Model Tax Convention that the Ad Hoc Group of Experts was entrusted to draft. Then, in 1979, the first U.N. Model Tax Convention was issued. It was updated in 1999, and published in 2001.

On October 6, 2010, the U.N. issued a report called "Arbitration as an Additional mechanism to improve the Mutual Agreement Procedure." It was prepared by the Subcommittee on Dispute Resolution within the Committee of Experts on International Cooperation in Tax Matters to consider the possibility of providing an arbitration procedure in the U.N. Model Tax Convention.[53] The 2011 update of the UN Model Convention was finally released on March 15, 2012, incorporating an arbitration mechanism in Article 25. Unlike the OECD Model Tax Treaty, the U.N. Model Tax Convention provides two alternative sets of Article 25; Alternative A is a provision providing a MAP only, while Alternative B contains arbitration language when the two competent authorities fail to reach a mutual agreement within a two-year-period.[54]

F. Conclusion

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[51] Altman, *supra* note 4, at 67.
[52] *Id.*, at 68 (providing that the Committee was initially comprised of 18 delegates).
[53] http://www.un.org/esa/ffd/tax/sixthsession/Report_DisputeResolution.pdf.
[54] United Nations [U.N.] ESCOR, United Nations *Model Double Taxation Convention between Developed and Developing Counties*, Art. 25 (2011) [hereinafter U. N. Model Tax Convention], available at http://www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf.

The evolution of tax treaties show that dispute resolution process was an inevitable part of the tax treaties from the inception of the tax treaties. Even though tax treaties were entered into in order to alleviate double taxation, it was the tax treaty itself that raised many disputes due to different interpretations of such terms as “resident” and “source.” Though the States and international institutions have always tried to resolve international tax disputes arising out of tax treaties, their preferred methods were different; the States preferred voluntary negotiation, which paved the way for the current MAP, while international organizations preferred a central international organization or tribunal, including arbitration. Eventually, the international organizations conceded to the reality of what the States were doing, i.e. adoption of the voluntary negotiation system for international tax dispute resolution, and further refined it leading to the birth of the current MAP provision in the OECD Model Tax Convention and the UN Model Tax Treaty. However, just because the international organizations adopted the voluntary MAP as a way to resolve international tax disputes, it does not mean that all the issues associated with the MAP have been identified and resolved. On the contrary, international organizations have been aware of the limitations of the voluntary negotiation as an international tax dispute resolution system between the States, and the MAP grew with such inherent issues.

The next chapter discusses such issues as how MAP works; who the interested parties are; what issues are associated with MAP, and tries to identify the ways to improve it or find alternatives.

CHAPTER 2. ANALYSIS OF MUTUAL AGREEMENT PROCEDURE

As discussed in Chapter 1, arbitration through an international authority was considered by international organization in the yearly years as one of the viable ways to resolve international tax disputes. However, the States preferred direct negotiation between the States to resolve disputes arising out of tax treaties and such preference was eventually reflected in the model tax treaties drafted by international organizations as early as in the 1940s.[55] Such direct negotiation method evolved into the current MAP that is found in most tax treaties worldwide. It was the OECD that refined the MAP process and adopted it in the model tax treaties in the 1960s. Furthermore, the OECD urged its member countries to follow the OECD Model Tax Convention in entering into bilateral tax treaties, to promote consistency and uniformity among tax treaties. As a result of such efforts, most of today's bilateral tax treaties are based on the OECD Model Tax Convention and those treaties have almost identical MAP process as a dispute resolution mechanism. Also, as discussed earlier, even though tax treaties are concluded by multiple States, much of the interpretation of the treaties are left to the fiscal authority and/or judicial authority of one State, which result in inconsistent tax consequences among the States. To alleviate the inconsistency in the national tax decisions, each nation's "competent authorities" resort to the MAP.

Discussed in the following sections of this chapter are: (1) legal and textual analysis of the current MAP provision in the OECD Model Tax Convention; (2)

[55] *See, e.g., supra* Ch. 1, Part II, Sec. C for the League of Nations' first model bilateral tax treaty that, for the first time, adopted the MAP, which was drafted in Mexico in 1946.

analysis of empirical statistical evidences which demonstrate that the OECD model fails to provide satisfactory resolution to taxpayers; and (3) possible forms of alternative dispute resolution methods in place of the MAP.

I. Why MAP Fails to Protect Taxpayers

A. How the Current MAP Works

Article 25 of the OECD Model Tax Treaty before the 2008 revision states that:

> *1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.*
>
> *2. The competent authority shall endeavour, if the objection appears to it 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.*

3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs.

The real world treaties are essentially the same as the OECD Model before the revision was made by adding Paragraph 5 in 2008. For example, one of the most recent tax treaties that Korea entered into is with Estonia which entered into force in May of 2010, of which Article 25 provides:

Article 25. 【MUTUAL AGREEMENT PROCEDURE】 [2010.05.25]

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

2. The competent authority shall endeavor, if the objection appears to it 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.

3. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs. When it seems advisable in order to reach agreement to have an oral exchange of opinions, such exchange may take place through a Commission consisting of representatives of the competent authorities of the Contracting States.

Under Paragraph 1 of Article 25, if the taxpayer considers that the actions of one or both of the countries result in taxation "not in accordance with the convention," he can present the case to the "competent authority"[56] of the country of which he is a resident. The only requirement is “taxation not in

[56] The term “competent authority” usually refers to the tax administration of a given country. In Korea, for example, the International Cooperation Division within the International Department of the NTS currently handles the MAPs.

accordance with the treaty" and this apparently seems to be an easy and simple solution to cross-border tax issues arising under double tax treaties. Furthermore, this apparently easy remedy is available regardless of domestic remedies as there is no requirement that the taxpayer seeks or exhausts the domestic remedies available.[57] However, there is a caveat in Paragraph 2 which provides that the competent authority of a Contracting State has the obligation under the treaty to "endeavor" through the MAP to resolve the issue by undertaking discussions with the other country.[58] The extent of obligation of competent authorities is to "try" to resolve the issues raised by taxpayers. Furthermore, Paragraph 4 provides much discretion to a competent authority in terms of communicating with other competent authorities as this specific paragraph does not require a competent authority to communicate but only requires that it "may" communicate with each other. Because there is no obligation to "resolve" under Article 25 as currently endorsed and adopted by almost all nations around the world, it necessarily follows that the incentive to reach an agreement is only marginal. In fact, if the two competent authorities are unable to agree, the taxpayer is potentially left with unrelieved double taxation, thus frustrating the principal purpose of the treaty. Another problematic aspect of the current MAP provision of the OECD Model Tax

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[57] Even the treaties entered into before Korea became a member of the OECD contain the language equivalent to the language used by the OECD Model Tax Convention. For example, the tax treaty between the U.S. and Korea states that "[N]otwithstanding the remedies provided by the national laws of the contracting states . . . .", which means that taxpayers can resort to a MAP regardless of domestic remedies available.

[58] In the OECD Model Tax Convention, the only condition for the competent authority to take in the case is that the taxpayer's objection "appears" to be justified. On the other hand, the Korea-U.S. tax treaty requires that the taxpayer's claim has a merit. Though there seems to be a difference between the two treaties, in essence, the taxpayer would not have brought the case to the competent authority, which is usually the last resort to a tax dispute, had there not been a conflict considered to be grave enough to go through the rather bulky and lengthy process.

Treaty is that it takes a long time to conclude. The procedures work better between some governments than others,[59] though the reason for such disparity is not so clear. In the end, the MAP is inadequate and dysfunctional at times because of its non-binding nature. Nonetheless, the MAP is the way in which most international tax disputes are resolved today, and for many countries it has been so for over 50 years. After all, the MAP is an informal negotiation process between the tax authorities of the disputing states, provided for in general terms in the tax treaty between them, with significant room for improvement and need for change.

B. Source of Conflicts: Different Objectives of Different Parties

The MAP does not work well from the perspective of taxpayers because the MAP itself is a voluntary act of negotiation between the States. Interests of the States and those of the competent authorities are not structure to well align with those of the taxpayers. In fact, the competent authorities, as one of the agencies that exist within the governments, and taxpayers have conflicting interest, which often makes the MAP fall short of the taxpayers' expectations. The following examines a few of such conflicting interests:

1. Conflicting Interest Between Government and Taxpayers

a. Government's interest

[59] For example, it is said that discussions between British and American competent authorities run relatively smoothly than negotiations involving officials from other governments. A few factors that may affect the discussions would be different language, culture, relative bargaining power, and the rigidity of legal systems, etc.

The governments must maintain three basic balances with respect to international tax dispute resolution. The first balance deals with the sovereignty of the States and the responsibility to protect its own taxpayers. States need to maintain the country's overall control over tax collection, tax policy, and tax legislation as part of their sovereignty. State compromises negotiate sovereignties when they negotiate and enter into treaties with another State because States wish to protect their taxpayers through a pragmatic mechanism which ensures compliance by other governments.[60] In entering into tax treaties, sovereign nations are reluctant to relinquish power beyond what they already have given up.[61] The second balance is between the need to secure resources for spending and redistribution and at the same time coordinate the allocation of the tax base and preserve good long-term international relationship with other countries.[62] The third balance is to secure foreign investments to promote economic growth[63] within the limit of the two balances discussed above. We can therefore expect governments to support a procedure that (1) offers flexibility to secure quick amicable resolution of disputes between States; (2) protect the rights of domestic taxpayers abroad; while (3) encouraging foreign investments.[64]

b. Government's Preference

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[60] Robert T. Cole, *Competent Authority Procedure: International Tax Counsel Gives His View*, 35 J. TAX'N 8, 8 (1971) (describing the U.S. Treasury Department as wearing two hats, one as the national tax administration agency and another as the representative of U.S. taxpayers).

[61] Lotfi Maktouf, *Resolving International Tax Disputes through Arbitration*, 4 ARB. INT'L 32, 40 (1988); OECD 1984 Report, *supra* note 45, at 38.

[62] Altman, *supra* note 4, at 245.

[63] Maktouf, *supra* note 61, at 41.

[64] Cole et al., *Mutual Agreement – Procedure and Practice*, 66a CAHIERS DE DROIT FISCAL INT'L, 1981, at 282 [hereinafter Cole et al. 1981 IFA Report]; Maktouf, *supra* note 61, at 41.

For the objectives discussed above, governments prefer a dispute resolution procedure that allows them to maintain control over their own tax policy and legislation without undue influence from abroad. Also, because governments are interested in maintaining good long-term diplomatic relationship with other countries, they prefer a flexible and informal system rather than rigid system. At the same time, governments also want to be able to disassociate itself from the dispute, so long as it does not affect its own tax collection, so as to avoid any waste of political capital in the midst of the dispute.[65]

c. Taxpayers' objective

Taxpayers' objective is simple; pay tax only once, if not less. Accordingly, they would prefer a system which limits the ability of governments to change their rights ex post. Taxpayers would prefer a system that would ensure compliance, stability, predictability, lower risk and transaction costs. Taxpayers are more interested in resolving the short-term tax issues, not long term diplomatic relationship. Therefore, taxpayers prefer a system that would allow them to stand up for their rights and call for decisive actions by governments. Also, taxpayers would like their governments to protect them when dealing with foreign tax administrations.[66]

2. Conflicting Interest Between Competent Authority and Taxpayers

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[65] Altman, *supra* note 4, at 244-50
[66] *Id.* at 245-50.

Having discussed the different objectives of the competent authority--i.e., collecting revenue while retaining its discretion in interpreting tax treaties--and those of the taxpayers--i.e., pay less tax by avoiding double taxation--the following describes a few areas of conflicts between the competent authorities and taxpayers in terms of dispute resolution process.

a. Flexibility of Process

The tax administration prefers a process that would allow it to maintain flexibility in interpreting tax treaties with limited international pressures, and to achieve its main objective of collecting revenue. Taxpayers, on the other hand, prefer a system that would suspend tax collection during a pending dispute resolution process.[67] Taxpayers also prefer a system capable of generating international pressure to secure relief from double taxation in all cases[68] though it may involve a third-party determination with limited tax authority discretion.[69]

Tax administrators prefer a procedure that would limit taxpayers' ability to opt out of the process once substantial time and efforts have been invested. Such procedure would limit the ability of taxpayers to enjoy procedural advantage of simultaneously pursuing their case in domestic courts and at the same time

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[67] Org. of Econ. Co-Operation & Dev. [OECD], *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, para. 4.42, at 144 (2010) [hereinafter OECD 2010 Transfer Pricing Guidelines].

[68] Altman, *supra* note 4, at 248 n.879; *See generally* Adrian A. Kragen, *Avoidance of International Double Taxation arising from Section 482 Reallocations*, 60 Cal. L. Rev. (1972.).

[69] Kragen, *supra* note 68, at 1515-1516.

profiting from the efforts of the tax administration during the MAP.[70] Taxpayers, on the other hand, prefer a system that would provide them flexibility in terms of the process and outcome.[71]

b. Transactional Cost

Treaty negotiators, who are usually representatives from the ministries of finance and/or the tax administration, would also prefer to reduce the political and transactional costs associated with the negotiation by concluding shorter treaties and leaving the ad hoc implementation in their control.[72] On the other hand, taxpayers would prefer a system that reduces their own transaction costs and risks, in which clear objective guidance is given, and ad hoc ex post implementation reduced to a minimum.[73]

c. Tax Policy

The tax administration would also prefer a process that would not limit its ability to safeguard the tax base of governments against treaty abuse and tax

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[70] Cole et al. 1981 IFA Report, *supra* note 64, at 281-82 (providing that the US national reporters to Cahiers was very specific about the position that taxpayers should not be allowed a legal right to be heard as that could slow down the entire MAP procedure).

[71] Altman, *supra* note 4, at 250

[72] *See generally* Cole et al. 1981 IFA Report, *supra* note 64 (providing that the US national reporters suggested that the current MAP provision in the treaties is sufficient, and that no further guidance needs to be implemented in the tax treaties).

[73] Altman, *supra* note 4, at 248; *Commission of the European Communities, Commission Staff Working Paper: Company Taxation in the Internal Market*, 267, SEC (2001) 582 final (Oct. 23, 2001) [hereinafter *Commission Staff Working Paper*].

fraud.[74] Taxpayers, on the other hand, would argue that such objectives should be kept outside the scope of treaty disputes and instead be properly addressed, not by double taxation, but by the other means under domestic laws. Naturally, the tax administration would prefer a mechanism capable of representing the interests of the majority of taxpayers rather than the interests of one taxpayer. Such a process might limit the ability of taxpayers to draw international attention to domestic practices that are not in conformity with international obligations.[75]

d. Taxpayer Participation

Tax administrations would also prefer a process with limited taxpayer participation that arguably might slow down the process or impede a free discussion with their counterparts.[76] In contrast, taxpayers demand full participation throughout the whole procedure, which would allow them the right to represent themselves and to receive full feedback and information, while ensuring that package deals do not adversely affect their rights.[77]

e. Transparency of Process

Tax administrations would also prefer a procedure with the least amount of transparency, thus allowing them to be f1exible in applying ad hoc solutions to

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[74] Cole et al. 1981 IFA Report, *supra* note 64, at 281 (commenting that it is the U.S. policy to accept all cases, i.e., MAP requests, in the absence of non-applicability of the treaty, procedural barrier, or fraud or the like).
[75] Altman, *supra* note 4, at 248.
[76] Cole, *supra* note 63, at 35.
[77] OECD 2010 Transfer Pricing Guidelines, *supra* note 67, at 144.

specific taxpayer grievances without the fear that others might also demand similar treatment.[78] While some taxpayers would also prefer such a procedure, on the whole most taxpayers would prefer a much more transparent system, providing them with guidance that reduces risk-associated costs. Taxpayers would argue that the tax administrations would also benefit from such transparency.

f. Information Disclosure

The tax administration claims that it must have unobstructed access to all relevant information to efficiently conduct the process. Taxpayers, on the other hand, prefer a system that would secure the confidentiality of their information and limits disclosure.[79] However, given that most taxpayers are ready to disclose all relevant information when they decided to initiate a MAP in order to save tax expenses, this conflict of interest seems rather theoretical than practical, and thus might have limited significance.

3. Conflicting Interests Within the Government

Intra-governmental conflicts also exist as a result of the different functions that each governmental department is required to perform. Tax administrations are entrusted with collecting revenue, while other parts of governments have much broader objectives. Thus, even though the common objective of governments is

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[78] Cole et al. 1981 IFA Report, *supra* note 64, at 281 (recommending against the publication of decisions as such publication would slow the resolution process and would be inconsistent with the U.S.' position that decisions of the domestic Appeals Offices are not published though they do recommend publication of general consultation procedures).

[79] *Id.*, at 257.

to secure long-term economic growth, the tax administration is influenced by its short-term revenue objectives.

The conflict is more precisely between the different departments within the government. For example, international trade authorities, would also have an interest in the taxation of international trade and commerce, and as the WTO grows wider in scope, so will the potential internal conflicts between domestic trade and other governmental departments.[80] For example, in Korea, there would be a difference in policy interests between the Ministry of Strategy and Finance ("MOSF"), which is in control of negotiating international tax treaties, with the Ministry of Foreign Affairs and Trade ("MOFAT"), which is in control of bilateral investment treaties and trade agreements, such as the Free Trade Agreement between Korea and the U.S. The MOFAT is likely to be interested in stimulating overall trade volume while the MOSF is likely to be interested more in how the trade agreements would impact the Korean economy and Korean taxpayers. The MOFAT would want to have control over negotiating trade agreements while the MOSF would want to have control over, or at least influence, certain relevant provisions within the trade agreements. Another example would be a conflict between the MOSF and the National Tax Service. The MOSF would be interested in the relationship between foreign investment and the overall Korean economy while the NTS would be more focused on collecting revenue.

4. Common Interests Among the Concerned Parties

[80] Altman, *supra* note 4, at 250.

While the available literature usually emphasizes the conflicts between the competent authorities (tax administration officials) and taxpayers, it should be noted that they also share some key objectives:

It is expected that both tax administrations and taxpayers prefer a quick and simple mechanism for resolving disputes to limit the time value of money (lost interest) and risk consequences.[81]

Both parties would support an affordable procedure with minimal compliance costs to taxpayers869 and minimal administrative costs to tax administrators.[82]

Both parties agree on the need for a mechanism capable of resolving all types of treaty-related disputes, which include, inter alia, complex tax issues, technological and other changing circumstances, as well as disputes involving more than three countries, without the need for treaty renegotiation.[83]

Tax administrations and taxpayers would also support a process capable of preventing future disputes and uncertainty by producing clear guidelines to

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[81] OECD 2010 Transfer Pricing Guidelines, *supra* note 67, at 144; Org. of Econ. Co-Operation & Dev. [OECD], Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, at 30-31 (1984) [hereinafter OECD 1984 Transfer Pricing Guidelines].

[82] *Commission Staff Working Paper*, *supra* note 73, at 274.

[83] *Id.*, at 287. The Paper expresses the concern that bilateral tax treaties are not normally capable of addressing triangular situations which can cause double taxation to go unrelieved. It gives an example where a corporation is incorporated in one Member State, managed and controlled in a second and derives income from a third. "The difficulty arises because two tax treaties are involved - that between the first State and the third State and that between the second State and the third State. The third State may withhold tax at source on the basis of one of those two tax treaties which will not be credited by one of the other States because it applies the other tax treaty which does not provide for a withholding tax at source."

taxpayers and tax administrators as to the interpretation and application of tax treaties.[84]

Additional mutual objectives would also include the need for a process capable of overcoming political, language, legal, and accounting differences. Also desired would be a process that is capable of securing the application of the outcome, which would eliminate domestic administrative, procedural and constitutional barriers, including as domestic time limits, conflicting court decisions and treaty overrides.[85]

C. Advantages v. Disadvantages of MAP

There are many papers and literature works on the theme that the MAP is not sufficiently functional, but they often fail to provide adequate explanations as for such result. In an attempt to show that the current MAP better serves the objectives of governments and competent authorities than the objectives of taxpayers, the following section will discuss the advantages and disadvantages of the MAP from the perspectives of governments and the taxpayers.

1. Benefits of MAP from the Perspective of Governments

a. Control by the Government

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[84] OECD 2010 Transfer Pricing Guidelines, *supra* note 67, at 143-150; Glenn L. Madere, *International Pricing: Allocation Guidelines and Relief From Double Taxation*, 10 TEX. INT'L L.J. 108, 130 (1975); John F. Avery Jones et al., *The Legal Nature of the Mutual Agreement Procedure Under the OECD Model Tax Convention – II*, B.T.R 13, 22-27 (1980).

[85] OECD 2010 Transfer Pricing Guidelines, *supra* note 67, at 143-150; Madere, *supra* note 84, at 130; Avery Jones et al., *supra* note 84, at 18.

Tax Sovereignty

Governments maintain control over process and outcome of MAP. They maintain control over the application of the treaty, and are able to limit the effect of the treaty on their tax sovereignty.[86] This process provides the tax administration with the ability to secure the collective rights of most taxpayers without jeopardizing the tax sovereignty, such as national policies or tax collection.

Treaty Negotiation

A MAP can be said to complement incomplete treaty negotiations.[87] Thus, it makes the treaty negotiations somewhat easier and less contentious, leaving many issues to be resolved later when disputes actually arise. Thus, it is important for governments and treaty negotiators not to involve any outside party in the MAP since this is generally seen as a part of the negotiations over the treaty itself.[88]

Minimum Reputation Risk

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[86] OECD 1984 Report, *supra* note 45, at 38 n.895 (stating that the taxpayer cannot speak for tax authorities of another, unless he is specifically empowered to do so, and therefore should in any way be empowered to act for a tax authority, meaning that it is the sole discretion of the government).

[87] Altman, *supra* note 4, at 254

[88] Even though Altman believes that somehow the MAP and the treaty negotiation complement each other, the opinion of the author of this paper is that the treaty should be negotiated to the fullest extent possible leaving the MAP to be invoked only when there is a difference in the interpretation of the treaty.

In many countries, competent authority has the sole authority to initiate a MAP and control the subject matter of a MAP case. In addition, the MAP is a confidential and non-transparent process, making it difficult for the business community to find out the details about a MAP case or even the existence thereof. Accordingly, governments are relatively free from the influence of international communities, including international organizations, taxpayer groups and other governments, during the MAP. Put differently, the MAP is a process that places only minimal risks with respect to the reputation of the government associated with a breach of treaty obligations or unilateral interpretation of the treaty. At the same time, it allows governments to signal taxpayers of their intentions to comply with the country's treaty obligations when necessary.

Control over Resources

The current system allows tax administrations to refuse a taxpayer's requests for a MAP since the competent authority is not obligated to accept all cases filed by taxpayers. Competent authorities thus deny taxpayer access in situations where fraud or other procedural barriers exist. This, in turn, prevents wasting resources on futile cases. This prevents wasting of resources of the tax administration and limits the costs to the reputation of the administrations and governments involved.

b. Informality

The MAP is a pleasant, informal and forward-looking process based on the good will of the parties who are experienced professionals. It enables the parties to reach an agreement fast as they become familiar with the tax systems involved.[89] The relationship of the competent authorities develops into a long term relationship, which makes negotiations easier. Also, as the competent authorities are willing to cooperate and coordinate, the MAP becomes a process focused on and capable of reaching amicable resolutions of disputes, sometimes without the need to negotiate complex treaty texts.[90]

Also, due to its informal nature, it helps to build personal connections and trust between the officers of the tax administrations of both countries, and allows for better and faster information sharing—this is important for international tax administration in the midst of the ever increasing number of international transactions.[91]

c. Flexibility

The MAP is a process that allows tax administrations to be flexible in applying ad hoc solutions to specific taxpayer grievances without the fear that others might also demand similar treatment.

d. Low Cost

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[89] Maktouf, *supra* note 61, at 42.
[90] Altman, *supra* note 4, at 253-54.
[91] Toshihiro Kiribuchi, *International Taxation: Competent Authorities Share Their Concerns: Japan*, 32 TAX NOTES 586, 590 (1986).

The MAP is generally an economical process, with minimal administrative costs compared to other alternatives involving international tribunal or international litigation.[92] However, as the MAP is unable to prevent countries from overriding their treaty obligations, either by specific legislation or by taxing practices, there is a hidden long-term cost stemming from the possibility of increased non-compliance by other States.[93] This cost can be significant for developing nations which are dependent on the trade with, and the capital from, developed countries. If a developed country does not wish to comply with its treaty obligations, the developing country would probably have to grant unilateral relief to maintain the inflow of capital and to preserve the competitiveness of its services and businesses abroad.[94] Therefore, the relatively low cost can be a benefit for developed nations while the benefit of such low cost is diminished by the cost of non-compliance for developing nations. However, considering that the MAPs are much common among the developed nations, the overall cost can be said to be inexpensive.

e. Non-Transparency

The MAP is generally a non-transparent process that limits the ability of political and interest groups to influence the professional agreements reached between two tax administrations. As discussed earlier, the non-transparent

[92] The administrative costs involved in the MAP may also be wasted since tax administrations must invest time and effort in understanding the case and presenting it to their foreign counterparts without any assurance that the dispute will be resolved by mutual agreement. However, if it was a case that would be wasted, it is more likely that the competent authority would not take the case to begin with, and therefore, the possibility of the administrative costs being wasted seems negligible.

[93] Altman, *supra* note 4, at 257-58

[94] Such unilateral relief becomes a cost to developing nations and also might not be compatible with its international trade obligations as it may be considered an export subsidy.

nature allows the competent authorities to be f1exible in applying ad hoc solutions to specific taxpayer grievances without the fear that others might also demand similar treatment. It also limits any reputation cost involved in failing to reach an understanding, and provides the competent authorities with the potential to reach package deals, if such deals are needed. Nevertheless, it is the impression of many practitioners that the MAP is highly politicized in nature in many countries, and that such politics have prevented compromises.[95]

2. Disadvantages of MAP from the Perspective of Governments

a. Lack of Enforceability

The competent authorities, if the domestic courts decide not to respect such mutual agreements that they reached, may not be able to enforce them because they are not binding on the courts in many countries. In Korea, for example, the International Tax Coordination Act specifically provides that where a final decision is made by a court after the conclusion of the MAP and the contents of such final decision are different from the terms and conditions mutually agreed, the said MAP shall be deemed non-existent from the beginning.[96] In practice, the court will probably give due consideration to the agreement reached by the two competent authorities and will try to respect the agreement reached. However, as it is written into the law currently, the domestic court has the right to preclude the application of the agreement reached by the two competent

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[95] Altman, *supra* note 4, at 255.
[96] International Tax Coordination Act, Art. 27(4), available at Samil Infomine [hereinafter ITCA].

authorities.[97] Furthermore, if a decision by domestic courts resulted in taxation arguably not in accordance with the treaty, a MAP cannot relieve the taxpayer from double taxation since the competent authority will not initiate a MAP.[98]

This aspect of a MAP is a disadvantage from the government's perspectives because it effectively limits the competent authority's ability to negotiate and enforce the mutual agreement. However, this is more of a disadvantage from the taxpayers' perspectives since it is the taxpayer that would end up with heavier tax burden in the end.

b. Rigidity

Although mutual agreements have a predefined life time, it is sometimes very difficult to amend the agreement in subsequent years even when the facts of the case have changed. Modifying this agreement would involve not only substantial legal costs from the taxpayer in the new MAP, but also substantial administrative and international political costs on the part of the competent authorities. Such agreements therefore have the potential to be extremely rigid and ineffective in a case involving a highly volatile situation.[99]

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[97] France is said to be different as the Minister of Foreign Affairs, and sometimes the Minister of Finance, has the exclusive power to interpret the treaty, and such interpretation cannot be questioned in domestic courts. *See* Altman, *supra* note 4, at 258 n.917; Avery Jones et al., *supra* note 84, at 17-18.

[98] ITCA, *supra* note 96, §22(2) (1).

[99] Sanford H. Goldberg & Claude Burleson, *Case Studies in Use of Competent Authority Provisions*, *in* 1977 TAX TREATIES AND COMPETENT AUTHORITIES 304, 304 (Virginia di Francesco & Nicolas Liakas eds., New York University Institute on Tax and Business Planning, 1978); Pierre Kerlan, *International Disputes With Respect to Tax Conventions – The French View*, *in* 1977 TAX TREATIES AND COMPETENT AUTHORITIES 219 (Virginia di Francesco & Nicolas Liakas eds., New York University Institute on Tax and Business Planning, 1978). Even though rigidness is cited as one of disadvantages of MAP, due to its cost and rigidness

c. Lack of Precedential Value

Due to the confidential and non-transparent nature, the MAP is incapable of generating guidance to other tax administrations or other departments of the same tax administration. Furthermore, no system of precedence or clear standards of review has been developed. Governments may therefore be required to use the services of international organizations, such as the OECD, to generate such guidance. This typically is a very time-consuming process. Some interpretive mutual agreements were nevertheless made public in Belgium, Canada, Germany, the Netherlands, Sweden, Switzerland, France, the United Kingdom and the United States. However, their numbers are limited and they do not include specific taxpayer agreements that might provide better guidance to tax administrators.[100]

d. Others

As opposed to the disadvantaged discussed above, some other disadvantages of the MAP are disadvantages only for the taxpayers, but not for the competent authorities. Also, some of them are just unavoidable situations that exist in all cross border disputes.

Altman points that the current process exposes the tax administration and the ministries of finance to increased pressures from domestic taxpayer groups

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once a MAP decision is rendered, it can be also an advantage to the extent that taxpayers do not abuse the MAP system.

[100] Avery Jones et al., *supra* note 84, at 18-20.

(powerful taxpayers, the ICC, academia and international tax attorneys), all of which demand better protection for taxpayers and lower risks associated with international transactions.[101] However, there is no guarantee that other alternative will provide better protection as each alternative will have its own caveat and possible defects, i.e., tax administration and the government will not be free from such constructive demands, which lead to their searching for a better solution.

Altman also points out that language barriers and political differences prolong the negotiation process and impede the tax administrations' abilities to resolve disputes through such negotiations.[102] However, this is not a disadvantage from the perspective of the government; rather it is an unavoidable situation for all international tax dispute resolution methods involving more than two different countries. To mitigate this problem, each tax administration will have to try to recruit better qualified professionals.

There is no uniform standard for the competent authorities in deciding whether or not to accept a case for consideration,[103] and the competent authorities of each country are given different authorities. This lack of uniformity is especially a matter of concern with respect to non-transparent administrative decisions and limits set during the delegation process. However, this is more of a disadvantage to taxpayers, not to tax administrations.

3. Benefits of MAP from the Perspective of Taxpayers

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[101] Altman, *supra* note 4, at 260.
[102] *Id.*
[103] Madere, *supra* note 84, at 130; Kragen, *supra* note 68, at 1514.

Most of the available literature fails to capture the full benefits that the MAP has to offer to the taxpayers, and instead concentrates on its disadvantages. Even the studies that do support the MAP focus on defenses against arguments made by the taxpayers rather than the procedure's benefits. The following section attempts to identify the MAP's most important benefits to taxpayers.

a. Professional Assistance at Low Cost

One of the main advantages for taxpayers in the MAP is the reduced administrative costs associated with the coordination and elimination of international double taxation. Many times the taxpayer is not required to pay anything at all to the administration at the time of filing for a MAP request, regardless of the nature of the disputes. However, this benefit is offset by the fact that there is substantial legal cost to be incurred by taxpayers.[104]

Taxpayers also benefit from the fact that the process is conducted by experienced tax administration[105] with extensive knowledge of their own tax system. This has the potential to limit misunderstandings, reduce the processing time and costs of disputes, and increase the probability of non-political resolution of the dispute.[106],[107]

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[104] *See infra*, Ch. 2, Part II, Sec. C.4.

[105] Yet, this is a standard argument in favor of the status quo in any debate on institutional change.

[106] Altman, *supra* note 4, at 265; *See also infra*, Ch. 2, Part II, Sec. C.4. (As will be discussed below, however, the OECD statistics and other empirical study indicate that the processing time of MAP cases is substantial. Also, there is a widespread impression on the part of taxpayers that the MAP is influenced politically).

[107] Kerlan, *supra* note 99, at 225-26.

However, the foregoing benefits are not always utilized to their fullest potential. In Korea, for example, the tax officers at the NTS rotate their position every two to three years. This rotation system hinders with the experienced officers' utilizing their knowledge on the MAP to the fullest extent possible. Furthermore, though the competent authorities' professionals are international tax experts, they are not necessarily experienced negotiators. Given that the outcome of a MAP inevitably depends heavily on the negotiation skills of such professionals because at the core of the MAP is a negotiation between the two countries, the officers' lack of credentials as negotiators undermine the professional merits of the competent authority.

b. Increased Guidance

The MAP provides a process with which new situations can be addressed through professional negotiations between the competent authorities. It saves time since renegotiation of the tax treaty itself takes a long time and is subject to political and interest group influences. Furthermore, recourse to the domestic remedy, either through an administrative appeal or a domestic tribunal, is not likely to provide relief if double taxation arises from an omission in the treaty or a difference between the two competent authorities on its interpretation.[108] Taxpayers are able to enjoy the increased guidance and a reduction in risk-associated costs. However, an incidence of such new situation leading to a MAP is rare and such benefit is available only if the results of the negotiations are made public.

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[108] *Id.*

c. Non-Transparency and Confidentiality

Taxpayers enjoy the increased confidentiality associated with the non-transparent MAP process. Unlike the procedures in domestic courts or international tribunals, the MAP receives little publicity. This is especially important if the taxpayers are interested in maintaining their good public reputation as taxpayers. The negotiations are much easier in a non-transparent environment. Reduced transparency may also increase the chances that foreign tax administrations, not connected to the income tax administration, will not be aware of the mutual agreement. This can be important in price adjustment cases where indirect taxes may be increased ex post to reflect the new price.[109]

d. Access to Court

A mutual agreement reached by the competent authorities is not binding unless it is accepted by the taxpayer. The taxpayer can ask the domestic courts to review the case by rejecting the mutual agreement. Thus, the MAP is a process that does not prevent taxpayers from having their day in the court, should they so desire.[110]

e. Others

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[109] Altman, *supra* note 4, at 267.

[110] Cole et al. 1981 IFA Report, *supra* note 64, at 281-282. Cole believes that taxpayers should not have the legal right to be heard in courts when such taxpayers had the benefit of the MAP. Nonetheless, taxpayers are free to choose. In practice, this benefit is not likely to be materialized as many courts will try to respect the mutual agreement reached by two competent authorities.

There can be certain benefits to taxpayers for MAP being informal and flexible as the non-controversial nature of the MAP also reduces the chances that the foreign tax administration will regard the dispute resolution process as contentious and subject the taxpayers to informal penalties, such as increased audits and other enforcement measures. The good-will nature of the process, and the close personal connections between competent authority officials, may also facilitate the accommodation of taxpayers' concerns.[111] However, this would be true only if the government's objectives do not conflict with the taxpayers' objectives. As discussed above, government's objectives are different from the taxpayers' interest and it is likely that the competent authorities will act for its own interest first, then for those of the taxpayers.[112]

4. Disadvantages of MAP from the Perspective of Taxpayers

a. High Transaction Cost

Internal Cost

It should not be overlooked that pursuing an issue in competent authority is not a matter without cost to a multinational. The actual cost of providing

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[111] Joseph G. McGowan, who was a Director International Operations at the IRS specifically mentioned that the revenue service representatives, who are stationed at U.S. embassies or consulates abroad, have developed many cooperative contacts with foreign tax officials, which helped to clarify the U.S. negotiating position and facilitate communication. Joseph G. McGowan, *Evolution of the U.S. Competent Authority Program*, *in* 1977 TAX TREATIES AND COMPETENT AUTHORITIES 281, 283 (Virginia di Francesco & Nicolas Liakas eds., New York University Institute on Tax and Business Planning, 1978).

[112] *See supra* Ch. 2, Part II, Sec. B. in general.

information to the competent authorities, if individual authorities insist on separate presentations and formulations of material, can be onerous.[113]

Legal cost

Almost all taxpayers hire a professional firm to assist them with a MAP in terms of submitting documents requested by the competent authority as well as the communication with the competent authority.[114] Almost all transfer pricing and permanent establishment cases are fact-intensive. In many cases, taxpayers do not have the ability to comply with the information document request made by the competent authorities, and therefore, it becomes the job of professional firms, either financial or legal counsels, to collect, analyze and communicate the information to the competent authorities. As a result, taxpayers often incur significant amount of professional cost which is aggravated by the fact that MAP cases take a long time to be resolved. Taxpayers therefore choose not to initiate the MAP unless the anticipated financial benefit from the resolution of the MAP is higher than the anticipated professional costs for the MAP.[115] In turn, this is the reason that MAP cases we see in practice involve a large amount of tax assessment, i.e., taxpayers would not initiate the MAP unless

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[113] Confederation Fiscale Europeenne, *C.F.E. Opinion Statement Questionnaire for Business on Procedures for Resolving International Tax Disputes*, (Sept. 12, 2003), *available at* http://www.cfe-eutax.org/sites/default/files/CFE%20OSt-on%20questionnaire%20for%20Business%20on%20Procedures%20for%20Re.pdf (last visited February 6, 2012) [hereinafter *CFE*].

[114] Goldberg and Burleson, *supra* note 99, at 293 (Goldberg, who is a tax lawyer, and Burleson, who is a VP Taxes of GTE corporation, talk about their actual experiences with the MAP. Particularly, Goldberg notes his role as a communicator between taxpayers and the competent authority); Madere, *supra* note 84, at 131.

[115] The author learned of a case in which a corporate taxpayer incurred over US$ 5.5 million of professional fees for a case involving a U$100 million tax assessment.

taxpayers are sure that the anticipated outcome is significant enough to offset the professional cost.

Furthermore, many taxpayers choose to make a "protective" appeal under domestic law to preserve the last opportunity to avoid double taxation in case the dispute is not resolved by the MAP to their satisfaction.[116, 117]

However, this benefit is offset by the fact that there is substantial legal cost to be incurred by taxpayers

Economic cost

The initiation of the MAP may not suspend the collection of tax deficiencies.[118] Since taxpayers are not always fully compensated for the time value of money, they turn to other procedures that suspend collection if possible. Similarly, in many cases the MAP will not be able to provide adequate relief for currency rate fluctuations. Some jurisdictions, however, do provide such relief.[119]

b. Potential Cost

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[116] Org. of Econ. Co-Operation and Dev. [OECD], OECD MODEL DOUBLE TAXATION CONVENTION ON INCOME AND Capital, Commentary to Article 25, para. 25, Doc. 10.1787/9789264175181-en (Jul. 22, 2010) [hereinafter 2010 OECD Model Tax Convention].

[117] Taking such practices into consideration, Art. 7.(1) of the European Arbitration Convention postpones the deadline, requiring the establishment of an arbitration panel before two years after "the judgment of the final court of appeal was given." Also, such practices may limit the ability of the competent authorities to negotiate a compromise. Thus, the OECD Commentary generally disapproves of these practices. *See* 2010 OECD Model Tax Convention, *supra* note 116, Commentary to Art. 25, para. 25.

[118] In Korea, the taxpayer may ask for suspension of tax collection while a MAP is pending. In such case, the taxpayer would be required to guarantee payment of the potential tax assessment by way of posting a bond.

[119] In Korea, refund is granted along with the interest.

Confidentiality was mentioned above as one of the benefits of the MAP from the perspectives of taxpayers since the information disclosed to the competent authority is not shared by other tax departments within the tax authority or with other government agencies. However, literature work on the MAP indicates otherwise. Taxpayers do fear the following three types of risks mainly from providing the information to the competent authority.

Risk of Further Adjustments

There is the potential risk that a jurisdiction will seek, as a result of an application under the process, to make further adjustments giving rise to increased, rather than reduced, double taxation.[120] This is particularly troublesome because there is no assurance as to the success of the MAP or that the information disclosed during the MAP will not be used against the taxpayer if the negotiations eventually fail.[121]

While the practices of the IRS and Japanese[122] tax administrations are to limit the disclosure of such information to other departments in the same tax administration, this is not always the case in other countries. Taxpayers in such countries are willing to suffer the loss of double taxation rather than invoke the MAP because they fear that the information disclosed would be used against

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[120] *CFE*, *supra* note 113, at 3.
[121] Cole et al. 1981 IFA Report, *supra* note 64, at 257.
[122] JAPAN NATIONAL TAX AGENCY, JAPANESE APA PROGRAM REPORT 8 (2004), http://www.nta.go.jp/kohyo/press/press/2004/040921/pdf/02.pdf.

them.[123] Some taxpayers choose to stop the MAP when they realize the existence of such risk.[124]

Cost of Risk for Future Audits

Although the process is built on the amicable settlement of the dispute, taxpayers realize that there are no safeguards that the foreign tax administrations will not penalize them for initiating the process. Taxpayers therefore not only fear audits but also retaliation and other adverse reactions from the foreign tax authorities for reopening closed tax years that have already been audited and informally agreed upon.[125] Competent authorities argue that that is an unsubstantiated fear.[126]

Moreover, taxpayers may fear that their own tax administration may raise new issues that may offset any potential tax refund from the MAP. Some countries, such as Canada and Germany, have specifically stated in the past that they give no guarantee as to raising such new issues.[127]

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[123] Goldberg and Burleson, *supra* note 99, at 299.

[124] The Canadian Revenue Agency reported a case in which the MAP could not be proceeded due to the refusal by the taxpayers to produce information. CANADA REVENUE AGENCY, CRA MAP PROGRAM REPORT 10-11, *available at* http://www.cra-arc.gc.ca/tx/nnrsdnts/cmp/mp_rprt-eng.pdf.

[125] Cole et al. 1981 IFA Report, *supra* note 64, at 257.

[126] Cole, *supra* note 63, at 12 (assuring the US taxpayers that MAP is to help the taxpayers and other foreign tax administrations share the same view. Robert Cole served in the US Treasury from 1967 to 1973 and was appointed as the first International Tax Counsel in 1971. He negotiated tax and other treaties for the US, including the one with Korea).

[127] Avery Jones et al., *supra* note 84, at 19.

It becomes more serious when the process alerts the competent authorities of the foreign country to perform an audit on the affiliate returns. In many cases, the foreign affiliate would simply prefer that its own tax administration forget about its existence,[128] not necessarily because of tax fraud or tax avoidance practices, but simply because the audit process is legally expensive and the nature of tax law is that there will always be bona fide disagreements between the tax administration and the taxpayer.[129]

Cost of Risk for Effects on Other Areas

Taxpayers also fear that the MAP will have adverse effects on tariffs and other import duties and penalties.[130] OECD Model Tax Convention specifically allows the competent authorities to share the information "…concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities…"[131]
Some concern was also expressed by taxpayers that the information disclosed to the competent authorities during the MAP may later be used in shareholder derivative actions, if and when a note is added to the financial statements indicating a settlement of tax liabilities.[132]

Taxpayers also fear that, irrespective of domestic confidentiality laws and the confidentiality requirement as stated in Art. 26 of the OECD Model Tax

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[128] Goldberg and Burleson, *supra* note 99, at 299.
[129] Altman, *supra* note 4, at 268.
[130] Cole et al. 1981 IFA Report, *supra* note 64, at 257.
[131] 2010 OECD Model Tax Convention, *supra* note 116, Art.26.
[132] Goldberg and Burleson, *supra* note 99, at 294-95.

Convention, valuable trade secrets, including their bottom line profits or losses, wil1be supplied to the foreign competent authorities and disclosed to their foreign competitors.[133]

Compliance Cost

The main cost for taxpayers of having a system based on domestic courts supplemented by international negotiation is associated with compliance obligations. Domestic courts are subject to legislative treaty overrides, or domestic interpretive treaty overrides,[134] and the nontransparent international dispute resolution system based on negotiations is unable to generate enough reputation costs to increase compliance by the government. Furthermore, given the above situation, tax treaties neither gives as much of a signal to taxpayers on the intent of governments to comply with their obligations, nor prevents future legislative overrides efficiently. Uncertainty and transaction costs are therefore higher. Taxpayers are, therefore, less protected against double income taxation. This, in turn, presents impediments for international trade and investments.

c. Uncertainty of Outcome

[133] Cole et al. 1981 IFA Report, *supra* note 64, at 257. The national reporters go on to say that it is not clear to what extent these concerns are valid. It would be an unusual case in which trade secrets would have to be disclosed to the competent authority, but much less to the foreign counterpart, in order to reach an agreement, which seems agreeable.

[134] Avery Jones et al., *supra* note 84, at 28.

One of the most prominent disadvantages of the MAP to taxpayers is that no assurance is given that an agreement between the competent authorities will ever be reached since competent authorities are not obligated to resolve a dispute; they are only obligated to "endeavor to" do so.[135] This subjects the taxpayer to the risk of double taxation when a deadlock occurs.[136] This is especially the case where the tax has already been collected in one country, and the tax administration will be required to issue a refund.[137] Some would even argue that this is the most important reason why the procedure is not used by taxpayers. The Confédération Fiscale Européenne ("C.F.E.") believes that, above all, it is the lack of any guarantee of elimination of double taxation that has a stultifying effect on the application of the MAP.[138, 139]

While the IRS and other tax administrations argue that such cases are rare, empirical evidence presented in Chapter 2, Section III below does seem to support such taxpayer fears. The 1981 statistics provided by the IRS indicated that the MAP was successful in providing full relief in only 74% of allocation cases and 54% in non-allocation cases over a ten-year period.[140] In Europe, for

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[135] *E.g.*, Article 25 of the Korea-Estonia Income Tax Treaty, which is the most recent income tax treaty that Korea entered into.

[136] Kragen, *supra* note 68, at 1541.

[137] *Id*. n.957.

[138] The C.F.E. presents itself as the leading European association of tax advisors. It was founded in 1959 and today embraces 33 national organisations from 24 European States, representing more than 180,000 tax advisers.

[139] Not all dispute resolution provisions in tax treaties are based on a negotiation by the competent authorities. *See e.g.* 2010 OECD Model Tax Convention, *supra* note 116, Art. 4(2)(d) (providing, on questions of taxpayer residency, that the contracting states "shall settle the question by mutual agreement."). However, no specific legal remedy is provided in the treaty if the competent authorities fail to reach an agreement. Furthermore, being an issue arising out of the treaty, it is likely that a taxpayer needs to invoke the MAP provision, which goes back to the original issue of MAP being a negotiation between the two competent authorities with only obligation is to "endeavor to resolve".

[140] *See infra*, Ch. 2, Part III, Sec. D for detailed explanation about allocation cases and non-allocation cases.

example, by 2000 only 77% of intra-European cases initiated in 1995 had been successfully resolved (67% of the Arbitration Convention cases).[141]

d. Time-Consuming

As it will be presented below utilizing the OECD MAP statistics and other empirical evidence,[142] MAP is extremely time consuming (and thus legally expensive), with cases lasting on an average of more than two years and many times much longer. Scholars and practitioners alike support this evidence and have also argued that the process is very time consuming.[143] One OECD report purports the taxpayers' failure to timely provide information to be one of the reasons for such time delay,[144] however the time consumption seems to be built into the design of the MAP. Competent authorities do not meet frequently, but only once or twice a year. If a dispute is not resolved at the first meeting, it will not be resolved for another year or so. The complexity of tax matters, language barriers, as well as legal and accounting differences may add to time consumption.

e. Government Controls

Another disadvantage of the MAP concerns the unlimited discretion given to the competent authority in deciding which cases to accept and which to reject. The inability of taxpayers in some countries to compel the competent

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[141] Altman, *supra* note 4, at 270.
[142] *See in general infra*, Ch. 2, Part III for the empirical data.
[143] Madere, *supra* note 84, at 130-131
[144] OECD 1984 Report, *supra* note 45, at 31-32.

authorities to initiate the MAP[145] as well as the lack of standards controlling such discretion can leave taxpayers feel helpless.[146] Such fears are especially high where taxpayers argue that their own tax administration is the one in breach of their treaty obligations. Under these circumstances one cannot expect taxpayers to request a MAP from their competent authorities since they can rightfully assume that the competent authorities will not subject themselves to international pressure and costs of reputation by accepting the request.[147, 148]

f. No Taxpayer Participation

On the flip side of the MAP being under the sole discretion of the government is that taxpayers in a MAP have little active involvement other than merely providing information, which can cause frustration among taxpayers.[149] Once

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[145] For example, US court dismissed taxpayer petition to compel the US government to initiate a MAP with Japan, *Yamaha Motor Corp., U.S.A., et al. V. United States of America, et al.*, 779 F. Supp. 610 (DC Cir., 1991)

[146] Madere, *supra* note 84, at 125.

[147] Kerlan, *supra* note 99, at 240-41. In this regard Mr. Pierre Kerlan, who in the 1970s served as the Director of International Tax Affairs at the French Ministry of Finance, admitted that:

We have already said that it must be admitted ...that in certain cases it may occur that the taxation authorities of the Contracting States - even when they have received a complaint from a taxpayer - are not very eager to seek a solution by mutual agreement with the other Contracting State. They may, in fact, either consider that the question raised is of secondary importance, or desire, if in doubt, to apply their domestic law when this is more favorable.

[148] Such taxpayers may also be barred under Art. 25(2) from directly submitting their claim to the competent authority of the other state. The only remedy left for them would therefore be the domestic courts. Other types of cases where taxpayers are not even expected to request a MAP and where the MAP is therefore ineffective include , inter alia: (i) cases where the statute of limitations has run out; (ii) cases involving taxpayer fraud; (iii) cases where the interpretation given by the taxpayer contradicts the policies of the tax administration; (iv) cases where similar MAP negotiations have previously failed;973 (v) cases where the tax administrations specifically agreed that they would not accept MAP requests;974 and (vi) cases where domestic treaty override legislation prevents the application of the treaty.

[149] G. Sass, *Effectiveness of the Current Competent Authority Procedures for Relief of International Double Taxation: Future Developments*, 1988 INTERTAZX 111, 112 (1988)

taxpayers present the case to the competent authority of their residence, unlike in litigation, the matter is outside their control. Also, taxpayers cannot force the competent authority to take the matter up with the other competent authority.[150] The competent authority decides whether to contact the other competent authority, and, together with the other competent authority, presides over the proceedings and decides on the outcome. As a result, it limits the ability of taxpayers to choose where to be taxed while eliminating double taxation.[151]

Tax administrations argue that direct participation of taxpayers might impede a free discussion between the competent authorities[152] and that private-party participation is contrary to international custom. While this argument can have some justification value if correct, given the increase in international tribunals that grant access to private parties, this claim is highly debatable today. Moreover, the special nature of tax treaties allowing reliance by taxpayers and having direct domestic effect would also make the justification of this argument very difficult.[153]

g. MAP is informal, flexible and non-transparent

(providing that the current MAP process limits the taxpayers' ability to choose where to be taxed and, at the same time, avoid double taxation); *see also* Cole, *supra* note 63, at 10 (introducing the tax administrators' argument that a direct participation from the taxpayers is not only contrary to international custom, but would also impede free communication among the competent authorities).

[150] Avery Jones et al., *supra* note 84, at 19.

[151] Cole et al. 1981 IFA Report, *supra* note 64, at 281.

[152] Cole, *supra* note 63, at 10 (Robert T. Cole was the US treasury's international tax counsel when writing his opinion.); *see also* Cole et al. 1981 IFA Report, *supra* note 64, at 281.

[153] Kerlan, *supra* note 99, at 261.

The MAP's informal and flexible nature was cited as its benefits from the government's perspective because such informality allows two competent authorities to have a good long-term relationship while reaching amicable resolutions of disputes faster without being contentious.[154] However, such flexibility and goodwill are not observed uniformly because many competent authorities are not given enough discretion by the state to allow for flexibility, and not all relationships among the competent authorities are characterized with good will. Also, the OECD statistics as well as other empirical evidence suggest that the benefit of being informal and flexible did not materialize in terms of processing time as MAPs take an average of two years and, in many cases, much longer.

Furthermore, the nature of non-transparency leads to the so-called "package deals"--i.e. cases in which agreements are not reached based on their merits, but for other reasons--which Maktouf asserts to be the main reason for competent authorities' preference for non-transparency.[155] In fact, there have been reports of "package deals" and "horse-trading" by the competent authorities.[156] Competent authorities with dozens or even hundreds of cases might be tempted to sacrifice a taxpayer as a bargaining chip in another case.[157] The propensity for such package deals is higher in an informal MAP meetings setting between the competent authorities, particularly when the officers of the each competent authority have developed personal ties. This situation is exacerbated by the non-

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[154] *See supra*, Ch. 2, Part II, Sec. C. for discussion of advantages and disadvantages of the MAP from the government's and the taxpayer's perspectives.
[155] Maktouf, *supra* note 61, at 41.
[156] Even though the OECD is cautious about accepting this argument as a fact, it must have been the competent authority officers who talked about it initially as there is no way for taxpayers to know what goes on in the MAP meetings.
[157] Park, *supra* note 13, at 809.

transparency of the procedure because taxpayers will not know about it. The existence of package deals and horse trading provides explanation to the fact that many mutual agreement solutions are often characterized by compromise, not by just results. Thus, though horse-trading could allow for quicker resolution while the taxpayers are sometimes indifferent about it, it is not a sustainable mechanism because it hinders the development of principled reasoning and can lead to taxpayers lacking confidence in the justice of outcomes.[158]

Furthermore, notwithstanding that the bilateral APA and the MAP, which are applicable to future and past transactions, respectively, are typically negotiated at the same time, a tax authority's reasoning and decisions can be inconsistent between the two. Burnett cites the MAP's lack of development and non-transparent nature as the reason for such disconnect.[159]

h. Politicized

In contrast to the intent of tax treaties, the MAP is highly politicized in many countries and politics often prevent the resolution of disputes.[160] Non-tax considerations are taken into consideration in the process, limiting its effectiveness and attractiveness to taxpayers. Taxpayers from developing countries are placed at a disadvantage since their competent authorities may not have the necessary negotiation powers to secure their rights because developed

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[158] Mario Züger, *Arbitration under Tax Treaties: Improving Legal Protection in International Tax Law,* 5 IBFD DOCTORAL SERIES, 2001, at 15.
[159] Chloe Burnett, *International Tax Arbitration*, 36 AUSTL. TAX REV., 173-90 (2007).
[160] Altman, *supra* note 4, at 255.

countries are politically more powerful and have greater leverage in negotiations during the MAP.[161]

i. Limited Relief

The specific case provisions of the MAP are also limited in scope and are designed to deal only with taxation not in accordance with the provisions of this Convention." Thus, the MAP is not intended to resolve all forms tax disputes. The ambiguity in the general text of tax treaties and the MAP provisions may in particular give reason for taxpayer concerns. For example, Article 9, Paragraph 2 of the OECD Model Tax Convention requires corresponding adjustments in transfer pricing disputes. However, because this provision does not deal with secondary adjustments, it remains unclear whether the MAP applies to cases involving such disputes.[162] Also, the language of the same provision provides for consultation between the competent authorities. However, this does not necessarily mean that the MAP of Art. 25 applies, though the competent authorities would probably apply the MAP procedure to disputes arising out of Paragraph 2 of Article 9. There are also other substantial tax disputes that do not come within the realm of the MAP; those disputes involve such issues as

[161] Competent authorities are able to use stalling tactics to prevent the resolution of the case in a timely manner. If one competent authority uses such tactics, the other competent authority may have no choice but to let their own taxpayers bear the burden of the excess tax or provide costly unilateral relief. Their choice will depend, among other things, on the political power of the taxpayer, power status of the two competent authorities involved, the possibility of having a government that prefers revenue collection, and etc. After all, political influence can be exerted in various different forms.

[162] 2010 OECD Model Tax Convention, *supra* note 116, Commentary to Art. 9, para. 8(providing specifically that it is not the purpose of the paragraph to deal with what might be called “secondary adjustments.”).

local taxes (which are not always covered by tax treaties),[163] treaty overrides, tax competition between countries over mobile capital,[164] tax subsidies on exports of goods and services,[165] tax policy and domestic tax legislation.[166]

The MAP is not designed to resolve multiple-jurisdictional cases based on bilateral treaties. The application of the MAP may be difficult in cases involving two or more countries that do not have a direct tax treaty between them.[167] This difficulty is exacerbated by domestic taxpayer confidentiality laws and Art. 26 of the OECD Model Tax Convention, which allows the competent authorities to share information only with their treaty counterparts. In today's globalized economy, where multinational enterprises frequently combine operations in more than two jurisdictions, such disputes are becoming more and more frequent.[168]

j. Lack of Precedential Value

Having no precedential value was one of the disadvantages from the perspectives of the government because other government agencies or different departments within the tax authority generally do not know of the details of the

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[163] Goldberg and Burleson, *supra* note 99, at 301-02.
[164] Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573 (2000)
[165] Alvin C. Warren, Jr., *Income Tax Discrimination Against International Commerce*, 54 TAX L. REV.131, 156-157 (2000). Warren argues that such subsidies are outside the scope of tax treaties.
[166] Kerlan, *supra* note 99, at 249.
[167] *Commission Staff Working Paper*, *supra* note 73, at 287.
[168] Altman, *supra* note 4, at 284 n.1031 (noting that about half of MAP cases involved two competent authorities during the period of 1971-1980, while one of the cases involved as many as 12 jurisdictions.)

MAP cases. It is also a disadvantage from the taxpayers as taxpayers generally get limited or no guidance from the cases that actually resulted in mutual agreement, since such agreements are many times never made public.[169] Thus, competent authority cases do not generate the necessary case law needed to reduce uncertainty and prevent future disputes. For the same reason, public scrutiny of such agreements is also virtually non-existent in many countries.[170, 171]

k. Enforceability

Interaction with domestic laws

The multi-national character of the MAP creates additional costs to taxpayers, i.e. the tax administration may not always be able to apply the mutual agreement because of domestic time limits, differing court opinions, and other procedural and substantive barriers under domestic tax legislation.

Domestic time limits are especially important in allocation cases where the related parties have different reporting schedules and different open and closed

[169] There are a few countries which published results of some MAP cases (mostly interpretive cases) such as Germany, Belgium Canada, the Netherlands, Sweden, Switzerland, France and the U.K. See Avery Jones et al., *supra* note 84, 22- 27.

[170] Altman, *supra* note 4, 275-76.

[171] In an effort to alleviate the foregoing concerns, Korea recently revised the related law provision to allow the Minister of Strategy and Finance or the Commissioner of the National Tax Service to release the result of the MAP cases publicly except when public harm may result from such public disclosure. Thus, such public notice remains discretionary as the Minister or the Commissioner "may" release such information.

years. Legal barriers, including the statute of limitations,[172] have made appeal to the MAP futile in many cases. Taxpayers tend to first try to resolve the dispute with the tax administration by making the adjustments, but by the time they reach a compromising agreement (the time required to refer the case to the MAP) the statute of limitations in the other country may have already run (either under the treaty or domestic law).[173] The OECD Model Tax Convention attempts to address the foregoing issues by providing in Art. 25(2) that "any agreement reached shall be implemented notwithstanding any time limits in the domestic laws." However, many countries made reservations on this provision, stating that this would place a burden on their tax collection and limit the assurance of revenue that domestic time limitations provide.

Limited ability to pursue protective course

Although the competent authorities do support taxpayers' filing an appeal in domestic courts to protect their rights, the competent authorities usually delay the appeal process, which limits the taxpayers' ability to pursue their cases in both avenues simultaneously. Korea does not have specific rules to limit domestic course of remedies. However, in practice, taxpayers rarely utilize both routes of remedies in fear of the possible backfire in case either of the authorities, the NTS or the court, finds out about it.

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[172] ITCA, *supra* note 96, §27, para.2, as revised effective from January 1, 2012; Org. of Econ. Co-Operation and Dev. [OECD], *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, para.4.42. (1995) [hereinafter OECD 1995 Report].

[173] Cole, *supra* note 63, at 8-9.

Furthermore, as a condition for the MAP, the tax administration making the adjustment might request the taxpayer to support its own tax administration and issue a statement that the adjustment was appropriate. Needless to say, such statements are extremely problematic for taxpayers, not only because they close all avenues for future litigation, but also because of their implications on customs valuation, other indirect taxes and financial statements.[174] Korean tax authority also seems to engage in such practice so that a taxpayer must sign a statement to the effect that the taxpayer accepts the mutual agreement for the reason that the mutual agreement is subject to taxpayer's consent.[175] However, when taxpayer agrees on the outcome, for example transfer pricing adjustment, customs authority can come in to challenge the taxpayer's price and try to assess customs duty, which is a significant risk for taxpayers.

D. MAP in Korea

The first income tax treaty signed by Korea was with Japan in 1970. The primary objective of the income tax treaty at that time was to attract foreign investors by providing relief from double taxation. As such, the income tax treaties entered into in 1920 and in the 1980s limit the taxing rights of Korea.[176] Also, as the objective was to attract inbound foreign investments, international tax dispute was almost nil at that time. The following is the dispute resolution provision implemented in the original 1970 income tax treaty between Korea and Japan:

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[174] Goldberg and Burleson, *supra* note 99, at 300.
[175] Informal interview with a former MAP officer.
[176] Lee, Yong Seop, International Taxation (11th ed. 2005) (이용섭, 국제조세, 세경사, 개정증보판 11 판, 2005).

Article 20

(1) The competent authorities of the Contracting States may communicate with each other directly for the purpose of giving effect to the provisions of this Convention.

(2) Should any difficulty or doubt arise as to the interpretation or application of this Convention, the competent authorities of the Contracting States shall endeavor to settle the question as quickly as possible by mutual agreement.

(3) The competent authorities of the Contracting States may, if necessary, also consult with each other in respect of the enterprise tax of Japan and the business tax of Korea.

Article 23

A taxpayer shall be entitled to present his case to the competent authorities of the Contracting State of which he is a resident or corporation, if he considers that the action of the other Contracting State has resulted or will result for him in taxation contrary to the provisions of this Convention. Should the taxpayer's claim be considered to have merit by the competent authorities of the Contracting State to which the claim is made, the competent authorities shall endeavour to come to an agreement with the competent authorities of the other Contracting State with a view to the avoidance of taxation not in accordance with the provisions of this Convention.

The combined effect of the foregoing two Articles for a MAP resemble the two

step process as recommended in the OECD 1963 Model Tax Treaty. In 1998, the two countries signed a new treaty in which the language of the MAP provision of the then current OECD Model Tax Convention was implemented.

The subsequent tax treaties that Korea entered into were not significantly different from the MAP provision of the then current version of the OECD Model Tax Convention. In 1995, MAP related provisions came into being when the International Tax Coordination Act ("ITCA") was promulgated.[177] Therefore, there was no MAP related provision in the law until 1995 even though the treaties already had MAP provisions and the first MAP case had been already completed.

The first MAP took place in 1988 with Germany for an agent PE issue on Bayer, which conducted extensive business in Korea through a business place owned by a third party. The NTS challenged Bayer and performed a tax audit on Bayer's Korean office. Bayer was not able to produce any documents at the tax audit. Eventually, the NTS made an assessment based on an argument that 100% of the sales in Korea should be attributed to the Korean PE. Bayer asked the German competent authority to initiate a MAP and the two governments agreed on a 40:60 split; 40% of profits taxable in Korea for the functions of sales and distribution in Korea and 60% in Germany for manufacturing function. The third party company in Korea housed a number of foreign companies that sold and distributed products and all these foreign companies were eventually challenged as well.[178] It should be noted that the absence of domestic laws was not a problem in the first MAP since it was initiated by the foreign country.

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[177] ITCA, *supra* note 96, Chapter 6, §22-§27-2.
[178] This information is from a source that would like to remain anonymous.

Going back to pre-1988, it seems that the NTS lacked the administrative and managerial ability to audit foreign companies; therefore, there was no MAP either. However, with the aforementioned first case, audits on foreign companies started to increase and the number of MAPs initiated by foreign countries also increased significantly by 1994. The government policy was also another reason for the lack of a MAP or an audit on foreign invested companies. In the 1970s and 1980s, the Korea government's policy was to attract foreign investments in Korea by providing tax incentives.

However, when the National Tax Service started examining foreign companies operating in Korea in late 1980s and early 1990s, mostly PE issues, such foreign companies were subject to double taxation. Therefore, they asked the competent authority of their home countries for a MAP, as exemplified by the first MAP case explained above. The promulgation of ITCA in 1995 was probably partially attributable to the increased demand for MAP from foreign jurisdictions.

In Korea, MAP cases are hardly rejected because taxpayers, through their counsels or representatives, asked the Korean competent authority whether they can initiate a MAP and whether their cases will be accepted by the Korean competent authority. Package deals did occur, according to a former NTS officer, and they were not necessarily bad, he commented, because it provided for a speedy resolution of the cases in the midst of the large caseload.

ITCA was revised a few times since 1995 to provide more guidance and to reflect the recommendations from the OECD. One of the recent revisions reflects such recommendation in that, as discussed above, the MAP provision

was revised to allow the Minister of Strategy and Finance or the Commissioner of the NTS to release the result of the MAP cases publicly except where public harm may result from such public notice; this revision was made for the purpose of providing more guidance on application of treaties and prevention of future disputes. Though such public notice is only discretionary, rather than mandatory, it certainly is a step toward an improved MAP system.

E. Reasons for Inadequacy of the MAP in Protecting Taxpayers' Rights

1. Inherent Limitation

As it can be seen above, many of the benefits of MAP from the perspectives of the governments are not benefits from the taxpayers' perspectives. There may be various reasons for such divergence, but the main reason seems to come from the fundamental difference in the objectives of the parties. As discussed earlier, the current MAP works better for governments because it was the governments that preferred and implemented the informal negotiation as the method to resolve international tax disputes.[179] Therefore, a MAP has to work inherently better for governments as it is the governments that gave birth to a MAP.

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[179] *See* Ch. 1, Part II, Sec. C. and D for discussions on how international organizations such as ICC recommended a third party organization or an arbitrator to handle cross border tax disputes, but it was the States that implemented informal negotiation between the States despite such recommendation. Such method of resolving international disputes through informal negotiations was finally accepted by international organizations and it was shaped into more formal process as it is now.

2. Conflict of Interest

a. Between Competent Authority and Taxpayers

Interest of taxpayers and the interest of the competent authority do not coincide. Taxpayers often resort to a MAP as a result of large amount of assessment by the competent authority. However, the primary focus of the competent authority is likely to be budgetary, i.e., maximize the revenue, therefore, often times the competent authority is not willing to accept the MAP itself when it is clear that the MAP would result in allocation of revenue between the two governments.[180] Therefore, the government's interest for revenue collection collides with taxpayer's interest of not being subject to double taxation.

Furthermore, in a larger picture, income tax treaties started between the two governments out of the motive and need to eliminate double taxation to facilitate international trades and investments. This objective is of the government, not of taxpayers. The MAP under tax treaties was, therefore, not designed by governments necessarily to provide an objective and fair outcome to the taxpayers, but rather to prevent double taxation through negotiations so that the governments can achieve their objectives.

b. Between the Two Competent Authorities

Each competent authority is probably interested in maximizing its own revenue, therefore, the two competent authorities may have different views on different

[180] KEVIN HOLMES, INTERNATIONAL TAX POLICY AND DOUBLE TAX TREATIES,399 (2007). An interview with a professional advisor also reflects the same.

cases of MAPs. These potentially unaligned interests of the competent authorities add uncertainty and taxpayers do not necessarily believe that the two competent authorities are really interested in resolving disputes and avoiding double taxation[181] which might also explain why the MAP was perceived by taxpayers as unhelpful.[182] In 2004 the OECD recommended that the role of the competent authority be clearly defined. It stated that "[t]he CA is not there to protect the revenue of their home country" and said that otherwise there is a risk that countries will not meet their treaty obligations.[183] The fact that even the OECD mentioned this indirectly proves that the governments have been trying to protect the revenue of their home country.[184] The 2003 Ernst & Young Transfer Pricing Survey also found that in some countries the competent authorities' interest in protecting revenue overrides any double taxation consideration.[185] The direr the financial needs of the government are, the less likely that the taxpayer will get adequate protection.

3. Agency Concern

The tax administration is not only a party to a dispute, but also administers it. In other words, "appeals are heard by a department of the same government which has already acted as prosecutor, judge and jury."[186] This creates agency

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[181] Cole et al. 1981 IFA Report, *supra* note 64, at 8-11.
[182] Madere, *supra* note 84, at 132.
[183] OECD 1984 Report, *supra* note 45, para. 38.
[184] The Canadian Revenue Agency did report that in at least one case over the past four years the other tax administration failed to respond to its MAP request. CRA MAP Program Report, at 11, http://www.cra-arc.gc.ca/tx/nnrsdnts/cmp/mp_rprt-eng.pdf (last visited Feb. 5, 2012).
[185] ERNST & YOUNG, TRANSFER PRICING 2003 GLOBAL SURVEY: PRACTICES, PERCEPTIONS, AND TRENDS IN 22 COUNTRIES PLUS TAX AUTHORITY APPROACHES IN 44 COUNTRIES [hereinafter E&Y 2003 SURVEY], Executive Summary at 4 (2003).
[186] Altman, *supra* note 4, at 204.

concerns. This is clearly indicated by the differing interests and objectives of tax administrators and taxpayers in the design of the dispute resolution mechanism. The MAPs are administered by tax authorities or ministries of finance in most countries. The major function of tax administration is to collect revenue from taxpayers. The perception of tax administration is powerful and sometime unpleasant for many taxpayers. However, during the MAPs, the tax administration becomes an agent for taxpayers, an agent who advocates taxpayers in negotiations. It is not difficult to imagine that taxpayers would have distrust in and doubts about the tax administration as to whether the tax administration would zealously advocate their case to the foreign competent authority.

This agency concern becomes more apparent in a few areas associated with the process. Taxpayers are not a formal party to the negotiations and have a limited ability to present their arguments in proceedings.[187] Therefore, taxpayers are concerned whether their cases are proceeding well or even whether they are proceeding at all. Lack of taxpayer participation and the non-transparency of the procedure promote fears that package deals are made between the competent authorities at the expense of the rights of taxpayers.[188] Taxpayers also fear that in any state-to-state dispute resolution procedures, political calculations may enter the decision, which may limit the ability of the competent authorities to address each case on its merits alone.[189]

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[187] Maktouf, *supra* note 61, at 376.
[188] OECD 1995 Report, *supra* note 172, IV-14, para. 4.42.
[189] It may be that the tax administration is specifically interested in controlling the arguments and the types of cases that proceed to the MAP, as well as their implications on its own similar practices and procedures, rather than the political ramifications thereof.

4. Procedural Inadequacies

Again, because the MAP evolved to be a negotiation between the two governments for private taxpayer's tax issue, the procedure also evolved to be more favorable to the governments as follows:

- The competent authorities are under no obligation to ultimately reach an agreement;
- The taxpayer has no right to initiate the mutual agreement process as the decision is left to the competent authorities;
- While the taxpayer has no legal remedy, other than the national courts, to enforce the treaty provisions, even the national courts can be blocked effectively while a MAP is proceeding;
- The taxpayer has no right to be heard over the process or be informed of the proceedings; and
- There is no obligation to publish the agreements that were reached.

5. Sub-Conclusion

Tax administrations claim that MAP is adequate to address international tax disputes and has functioned well so far. It is true that MAP has proven to be valuable in resolving international tax disputes for many taxpayers, but many other taxpayers have not been so lucky. Some taxpayers give up even before initiating the MAP at the expense of double taxation, and the MAP has provided satisfaction to only limited number of taxpayers due to various reasons discussed above, including the absence of any incentive for the relevant tax administrations to reach an agreement when taxpayers are desperate. The process is entirely permissive and non-binding. The competent authorities are to

"endeavor" to resolve cases, but nothing is said of what happens when they do not. In practice, delays are common and it is costly. It seems that the tax authorities are permitted to pay only lip service to international cooperation while following their narrow national interests.[190]

II. MAP Statistics: Empirical Evidence

A. OECD Statistics

The OECD recently released Country Mutual Agreement Procedure Statistics. The analysis of OECD member country MAP statistics was originally proposed as an area for future study in a 2004 draft progress report on improving the resolution of cross-border tax disputes,[191] and later the OECD concluded that a periodical analysis of member country MAP caseloads would be useful. The OECD 2007 Report contains the details about the MAP reporting framework, which was approved by the Committee on Fiscal Affairs.

The first such MAP statistics report came out in September of 2009 for the 2006 and 2007 reporting periods with respect to new cases initiated in the given reporting year and the cases remaining by the end of each reporting year. Subsequently, three more reports came out, in 2010, 2011 and the latest one on

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[190] The OECD has recently developed an online Manual for Effective Mutual Agreement Proceedings (MEMAP) as part of a wider project to improve the effectiveness of the MAPs, which may ease some of the shortcomings mentioned above; however, many of the MAP's shortcomings are inherent due to its being an informal process presided over by the competent authorities. MEMAP is a*vailable at* http://www.oecd.org/dataoecd/19/35/38061910.pdf.

[191] Org. of Econ. Co-Operation and Dev. [OECD], *Improving the Process for Resolving International Tax Disputes* (2004) [hereinafter OECD 2004 Report].

August 30, 2013, for the reporting periods of up to 2012.[192] The statistics are linked to the details that each country provided and a breakdown is provided in terms of how old the cases are. However, the statistics are far from complete as some countries provide more information than others, some countries report the statistics based on methods different from the OECD suggestion, and the scope of data is also limited; it is therefore difficult to make meaningful interpretation out of them. Nonetheless, it is still significant itself as it is the only data concerning the MAPs that is officially and publicly available. This can be a good starting point for academics, practitioners and government sectors to research and study in the area of MAP, which have been relatively difficult due to the scarcity of information in the past. Furthermore, as the data accrue in the coming years, they will grow to be more useful and coherent in terms of the specifics.

1. Definitions[193]

Before going into the analysis, defined below are the important terms used in reporting the MAPS by countries

a. MAP Case

[192] Org. of Econ. Co-Operation and Dev. [OECD], *Country Mutual Agreement Procedure Statistics*, released on 30 August 2013, *available at* http://www.oecd.org/ctp/dispute/2012mapstatisticsreleased.htm (last visited November 3, 2013). All the table figures that appear in this section come from the OECD statistics except noted otherwise below the table.

[193] OECD 2007 Report, *supra* note 2, Annex II, at 50.

MAP case refers to a case arising from a request made by a person pursuant to the MAP provisions of a tax convention including (i) a case arising from a request submitted directly to that competent authority by the taxpayer; and (ii) a case arising from a request submitted by the taxpayer to the competent authority of the treaty partner and subsequently presented by the latter competent authority to the former competent authority.

These cases typically involve situations where taxpayers are subject to taxation not in accordance with the provisions of a relevant tax convention, predominantly it involves situations of double taxation, and it could be a case of a determination of a taxpayer's residence in dual resident situations. However, a MAP case for the reporting purpose does not include a request for an Advance Pricing Arrangement (APA).[194]

b. New Case

The Reporting framework refers to new cases as "Initiated Cases." An "initiated" case is one that has been accepted by a competent authority. In most cases, competent authorities will accept a request for competent authority assistance via MAP on the date the request is considered complete, and this is commonly evidenced by a notification from the competent authority to the requesting taxpayer that the request has been accepted. A "complete request" is one where there is sufficient information for the competent authority to decide whether the objection underlying the case appears to be justified. For this purpose, a merely "protective" competent authority filing, which refers to a situation where a

[194] *Id.*, Annex II, at 49-52.

filing is made before the expiration of a time limit on making a competent authority request, but which does not contain enough information to allow the competent authority to decide whether the objection underlying the case appears to be justified, should not be considered an "initiated" case. A case which is presented to a competent authority by the competent authority of another State pursuant to a request submitted to the latter competent authority would typically be considered "initiated" for purposes of the former competent authority's statistics when the former competent authority receives that presentation, unless the former competent authority promptly thereafter notifies the latter competent authority that the request is incomplete or is otherwise not accepted for MAP discussions. By definition this section will include only cases initiated during the current reporting period.

c. Average Cycle Time

Average cycle time means the average time to complete a MAP case. This average shall be calculated by first aggregating the number of months it took to complete or close each case (including any withdrawn case) that was completed, closed or withdrawn during the reporting period, from the date of initiation until the date of completion, closure or withdrawal. Then, the aggregated number of months is divided by the total number of such completed, closed, and withdrawn cases. The result is the average cycle time of a MAP case in months, or in other words, the average number of months to complete a MAP case.

d. Reporting period

A reporting period is any 12-month period for which a competent authority prepares statistics relating to its Mutual Agreement Procedure (MAP) program. The reporting period for a specific calendar year is either that calendar year or any 12-month period ending during that calendar year, whichever best corresponds to the competent authority's recordkeeping practice. Thus, for example, the 2006 reporting period would be calendar year 2006 for a competent authority that maintains records on a calendar year basis, or would be the period from 1 October 2005 to 30 September 2006 for a competent authority that maintains records on the basis of a year ending on 30 September. To achieve maximum consistency in the data, countries are strongly encouraged to report on a calendar year basis, but use of a non-calendar year reporting period is acceptable if a country finds calendar year reporting to be too burdensome. For example, Japan's reporting is made based on a fiscal year basis, which has the June year end.

e. Other Terms

There are other defined terms such as "Year Initiated," "Closed or Withdrawn Case with Double Taxation," "Completed Case," "Opening Inventory," and "Ending Inventory." These are self-explanatory and can be easily referenced to the OECD report.

2. Number of New Cases

In 2010, the MAP reporting framework was modified so that the countries report MAP cases with OECD countries separately from those with non-OECD countries in order to better reflect the fact that the MAP cases are reported by

two countries, i.e., they are double counted. In general, more than 90% of OECD member countries' MAP inventories are cases with other OECD member countries.

<Table 1: Number of New MAP Cases>

Countries	2006	2007	2008	2009	2010	2011	2012	Annual Average
U.S.	240	257	308	326	252	279	236	271
France	104	100	154	169	135	173	181	145
Belgium	31	30	71	213	120	120	151	105
Canada	76	70	85	103	101	94	87	88
Switzerland	-	45	99	119	65	112	120	80
Sweden	72	61	104	64	104	111	100	88
Netherlands	80	57	-	64	51	34	83	53
U.K.	-	55	44	56	68	54	69	49
Japan	37	49	40	44	34	22	31	37
Austria	29	26	36	30	38	35	61	36
Spain	18	67	24	24	24	18	36	30
Germany	212	186	177	177	150	306	277	212
Luxembourg	22	31	31	25	35	75	39	37
Norway	15	21	30	21	16	7	10	17
Italy	14	20	14	31	22	41	45	27
Denmark	15	18	21	22	20	24	24	21
Australia	9	13	8	19	21	10	10	13
Korea	8	9	13	25	13	24	22	16
Poland	11	7	19	14	7	9	5	10
Portugal	10	7	5	14	17	15	17	12
Mexico	14	11	5	10	4	5	17	9
Finland	1	11	8	5	11	13	14	9
Ireland	3	3	2	6	7	6	12	6
New Zealand	4	5	2	6	4	4	3	4

Hungary	4	3	1	2	1	0	1	2
Turkey	0	2	1	3	4	0	0	1
Greece	1	2	-	-	-	5	3	2
Israel	-	-	-	-	4	9	5	3
Iceland	1	0	0	0	0	1	2	1
Slovak	0	-	1	1	3	4	1	1
Slovenia	-	-	3	0	2	2	3	1
Total	1036	1176	1311	1599	1341	1624	1678	1395

3. Average Processing Time for Cases Completed

For the OECD member countries for which data was provided, the average time for the completion of MAP cases with other OECD member countries was 25.46 months in the 2012 reporting period. The average time for the completion of MAP has generally increased since 2007 in which the average time for completion of MAP was 18.93 months. The number of new MAP cases increased while the number of new cases increased as well, which necessarily implies that the number of cases pending at any given year is increasing as well. In fact, the number of MAP cases pending as of the year end has shown a steady increase from 2352 cases for OECD countries in 2006 to 4073 cases in 2012. (MAP cases involving two OECD member countries are double-counted in this total).

The following tables summarize the statistics in terms of number of new cases, average processing time and the number of pending cases for selected countries. The statistics for Korea is discussed separately in Part C below.

<Table 2: Country Specific MAP Statistics of Selected Countries>

US	Opening Inventory	New Cases	Completed Cases	Ending Inventory				Average Processing Time (# of months)
				0 ~ 2 years	2 ~ 4 years	Cases> 4 years	Total	
2006	424	240	234	-	-	-	430	24
2007	430	257	187	-	-	-	500	19
2008	500	308	230	-	-	-	578	22
2009	578	326	180	-	-	-	724	24
2010	724	252	271	-	-	-	705	29
2011	705	279	298	-	-	-	686	27.6
2012	477	236	140	-	-	-	573	24.17

* The US included APA cases in the statistics until 2011, but decided not to include the APA cases from 2012. Accordingly, the opening inventory for 2012 does not reconcile with the ending inventory of 2011.

UK	Opening Inventory	New Cases	Completed Cases	Ending Inventory				Average Processing Time (# of months)
				0 ~ 2 years	2 ~ 4 years	Cases> 4 years	Total	
2006	-	-	-	-	-	-	0	-
2007	84	55	30	87	18	4	109	29
2008	109	44	47	77	21	8	106	27
2009	126	56	61	80	28	12	120	22
2010	126	68	56	81	30	16	127	28~29
2011	127	54	48	90	24	19	133	23
2012	133	69	54	91	34	18	143	22.43

Germany	Opening Inventory	New Cases	Completed Cases	Ending Inventory				Average Processing Time (# of months)
				0 ~ 2 years	2 ~ 4 years	Cases> 4 years	Total	
2006	444	212	155	319	73	84	476	-

2007	476	186	125	324	124	78	526	-
2008	527	177	171	294	148	77	519	-
2009	419	177	127	296	159	88	543	-
2010	543	150	183	291	130	63	484	-
2011	619	306	150	449	160	93	702	-
2012	702	277	138	485	211	91	787	-

* German competent authority's internal case database does not allow the recording of "initiated" and "completed" dates following OECD definitions. For the years prior to 2011, German competent authority made efforts to prepare the statistics for OECD purposes, but is no longer able to prepare separate statistics. From 2011, Germany provides statistics generated by its own internal database, therefore, the opening inventory number for 2011 does not reconcile with the ending inventory of 2010.

France	Beginning Inventory	New Cases	Completed Cases	Ending Inventory				Average Processing Time (# of months)
				0 ~ 2 years	2 ~ 4 years	Cases> 4 years	Total	
2006	278	104	128	150	52	52	254	38
2007	254	100	121	141	54	38	233	36
2008	301	154	127	196	71	61	328	30
2009	328	169	70	248	99	80	427	22
2010	427	135	65	263	138	89	490	35
2011	490	173	106	266	160	113	539	32
2012	539	181	169	301	143	107	551	41

Canada	Beginning Inventory	New Cases	Completed Cases	Ending Inventory				Average Processing Time (# of months)
				0 ~ 2 years	2 ~ 4 years	Cases> 4 years	Total	
2006	135	76	70	92	35	7	134	23.82
2007	148	70	60	115	30	8	153	23.64

2008	150	85	46	128	45	13	186	24.63
2009	186	103	74	151	43	12	206	29.76
2010	202	101	74	153	60	12	225	23.43
2011	225	94	81	160	50	14	224	30.88
2012	232	87	89	156	56	10	222	30.49

* The opening inventory of 2012 was restated to reflect a change in status from "protective filing" to "initiated", therefore, the ending inventory of 2011 does not reconcile with the opening inventory of 2012.

The Nether-lands	Beginning Inventory	New Cases	Completed Cases	Ending Inventory				Average Processing Time (# of months)
				0 ~ 2 years	2 ~ 4 years	Cases> 4 years	Total	
2006	96	80	56	-	-	-	120	-
2007	120	57	26	-	-	-	151	-
2008	-	-	-	-	-	-	127	-
2009	128	64	73	-	-	-	118	20.7
2010	107	51	61	-	-	-	97	24.2/29*
2011	97	34	32	-	-	-	99	22.2/56.2
2012	99	83	52	94	37	9	140	16.6/27

* Numbers after slash means the number of months taken for MAP with non-OECD countries.

Sweden	Beginning Inventory	New Cases	Completed Cases	Ending Inventory				Average Processing Time (# of months)
				0 ~ 2 years	2 ~ 4 years	Cases> 4 years	Total	
2006	57	72	33	60	18	16	94	-
2007	101	61	60	60	18	22	100	-
2008	99	104	76	78	27	20	125	16
2009	125	64	85	44	38	21	103	14

2010	103	104	73	66	35	33	134	17
2011	134	111	82	102	28	33	163	22.9
2012	163	100	64	122	38	38	198	20.1

Switzer-land	Beginning Inventory	New Cases	Completed Cases	Ending Inventory				Average Processing Time (# of months)
				0 ~ 2 years	2 ~ 4 years	Cases> 4 years	Total	
2006	-	-	-	-	-	-	0	-
2007	33	45	44	30	3	-	33	-
2008	15	99	29	85	3	-	88	-
2009	88	119	64	140	3	-	143	-
2010	143	65	66	130	12	-	142	-
2011	142	112	67	137	50	-	187	-
2012	187	120	76	180	51	-	231	-

Japan	Opening Inventory	New Cases	Completed Cases	Ending Inventory				Average Processing Time (# of months)
				0 ~ 2 years	2 ~ 4 years	Cases> 4 years	Total	
6. 2006	58	37	28	48	16	3	67	-
6. 2007	67	49	31	71	11	3	85	-
6. 2008	85	40	43	65	17	-	82	-
6. 2009	82	44	36	65	25	-	90	-
6. 2010	90	34	49	47	28	-	75	-
6. 2011	75	22	36	35	26	-	61	-
6.2012*	61	31	22	44	26	-	70	-

* 6.2012 numbers are quoted from the NTA's MAP report.

4. Number of Cases Closed or Withdrawn with Double Taxation

A case is closed on the day that the tax administration provides a written notification to the taxpayer that the competent authority cannot and will not be able to reach a resolution and there is no further recourse. Unfortunately, many countries which participated in the OECD survey on the use of MAPs did not disclose the information on the number of cases closed or withdrawn with double taxation during the reporting period. Table 2 shows the available data from more compliant countries, which proves that not all MAP cases are "resolved" in a sense that the taxpayers obtain relief from double taxation.

<Table 3: Number of MAP Cases Completed, Closed or Withdrawn>

	Year	Completed Cases	Closed or Withdrawn with Double Taxation
Austria	2006	25	4
	2007	16	2
	2008	12	1
	2009	15	0
	2010	51	1
	2011	21	10
	2012	34	2
Canada	2006	70	7
	2007	60	5
	2008	46	3
	2009	74	9
	2010	74	4
	2011	81	14
	2012	89	8
Germany	2006	155	25

	2007	125	11	
	2008	171	14	
	2009	127	12	
	2010	183	26	
	2011	150	73	
	2012	138	54	
UK	2008	47	1	
	2009	61	1	
	2010	56	11	
	2011	48	0	
	2012	54	5	
Sweden	2006	33	2	
	2007	60	2	
	2008	76	2	
	2009	85	1	
	2010	73	0	
	2011	82	0	
	2012	64	1	
US[195]			Partial Relief	No Relief
	2006	234	4.42%	13.18%
	2007	187	0.23%	4.02%
	2008	230	3.34%	7.40%
	2009	180	3.40%	1.01%
	2010	271	1.78%	1.60%
	2011	298	0.78%	21.48%
	2012	140	1.84%	2.17%

5. Sub-Conclusion

[195] The U.S. statistics were different in that the number of completed cases included cases closed or withdrawn. Instead, the U.S. provided the percentages of cases with relief, partial relief or no relief. Percentages shown in the table are cases closed with double taxation or partial double taxation. The majority of cases (remaining cases) were closed either with correlative adjustments or adjustments withdrawn.

The above statistics seem to suggest that the MAPs are generally underused as the number of MAP cases seems to be fairly low given the extent of international trade and investments of the OECD countries. It has been conceded by a few fiscal authorities, including those of the U.S. and Germany, that the MAPs are underused as early as in 1977 during a conference organized by the International Institute on Tax and Business Planning.[196] Furthermore, as will be discussed below, the E&Y Transfer Pricing Global Survey indicates that less than 20% of multinational firms use MAP as a mechanism to resolve international tax disputes. The Survey even indicates that some multinational companies even give up on appealing the case, even if it results in a double taxation.

B. E&Y Global Transfer Pricing Survey

1. Introduction

In 1995, Ernst & Young ("E&Y") started issuing a global transfer pricing surveys. The surveys are carried out by Consensus Research International, based in London, by conducting interviews with multinational enterprises (MNEs) as well as tax authorities. The survey reports summarize the transfer pricing practice, perceptions, and audit experience of MNEs' tax departments. They also provide insights into how they are dealing with economic, regulatory and fiscal changes taking place around the world. The reports have some

[196] McGowan, *supra* note 111, at 285.

statistics on the use of the MAP by MNEs as well as other relevant aspects thereof as summarized below.

2. 2003 Survey

In 2003, E&Y commissioned independent interviews with 641 parent companies and 200 subsidiary corporations in 22 countries. 86% of parent and 93% of subsidiary respondents identified transfer pricing as the most important international tax issue they face. Some of the survey results include:

- All companies are exposed to audits; however the larger companies have a higher than average exposure;
- One-third of audits are concluded with an adjustments;
- 40% of transfer pricing adjustments resulted in double taxation;
- Only 19% of adjustments were appealed;
- Less than 20% of survey respondents have used the competent authority process; and
- Only 14% of parents and 18% of subsidiaries used the APA process

Table 4 shows the number of audits and the percentage of those audits that resulted in adjustments in selected countries. Korea is shown to have the highest percentage of audits leading to adjustments.

<Table 4: Percentage of Audits Completed with Adjustments>

Examining Country	No. of Audit Cases	% resulting in adjustment
Australia	27	11%
Belgium	18	28%
Canada	56	45%

France	79	25%
Germany	113	41%
Italy	33	51%
Japan	31	39%
Korea	23	59%
Netherlands	47	57%
Norway	27	15%
Spain	16	8%
UK	110	33%
USA	133	40%

3. 2007-2008 Survey

2007/2008 Survey Report[197] surveyed some 850 MNEs across 24 countries. Of the 850 MNEs, 655 were parent companies interviewed from the MNE headquarters perspective and 195 were inbound subsidiaries interviewed from the local operating company perspective.

The result of the survey indicates that:

- 21% of parent respondents have used an APA as a controversy management tool , which is an increase from 14% ~ 18% in 2003;
- 17% have referred a transfer pricing matter to a competent authority; and
- only 4% have litigated a transfer pricing issue.

Globally, there appears to be a moderate trend for both parent and subsidiary respondents to rely less on a process offered by the competent authority.

[197] *Available at* http://www.worldcommercereview.com/publications/article_pdf/60

4. 2010

For 2010 Survey Report, 877 MNEs across 25 countries were interviewed. The result of the 2010 Survey indicates that:

- 23% of parent respondents have used an APA as a controversy management tool since 2007;
- Only 18% of all respondents have referred a transfer pricing dispute to a competent authority in the last 3 years
- 10% of all respondents indicated that they used a litigation as a method to resolve transfer pricing dispute.
- 2% of respondents indicated use of binding arbitration as a way to manage tax controversy.

5. Sub-Conclusion

Overall, the ratio of adjustments or tax issues being referred to competent authority procedures remains at less than 20% ranging 17%~18%. The reports indicate that some companies do not refer the cases to competent authorities even when they would be subject to double taxation because (i) the amounts at issue are not large enough to justify the cost involved in challenging the assessments; (ii) brining the matters to competent authorities may open the door to the tax authorities for other matters; (iii) there is a lack of trust in the competent authority in terms of whether the competent authority would try its best to resolve the issues in favor of the taxpayer; and (iv) it takes a long time and taxpayers are not willing to accept the uncertainty that long.

At the same time, companies are becoming more proactive in terms of managing tax controversy as the number of companies that choose to litigate disputes increased significantly in addition to APAs. Furthermore, a few companies are already choosing binding arbitration to resolve international tax controversies as revealed in the 2010 Survey Report.

C. MAP Statistics for Korea

It was said earlier that the empirical data regarding the MAPs are scarce and rare, mainly due to the nature of confidentiality and non-transparency. Korea is no exception and the only data available are from the OECD and the APA Annual Reports published by the National Tax Service of Korea. Though Korea has relatively scarce MAP statistics even among the OECD countries, some information is available as follows:

<Table 5: OECD Statistics for Korea>

Korea	Beginning Inventory	New Cases	Completed Cases	Ending Inventory				Average Processing Time (# of months)**
				0 ~ 2 years	2 ~ 4 years	Cases> 4 years	Total	
2006	48	8	28	16	5	7	28	22
2007	28	9	7	16	6	8	30	24
2008	30	13	13	18	7	5	30	21
2009	30	25	8	33	7	7	47	19
2010	47	13	16	32	11	1	44	22.4
2011	44	24	8	35	19	5	59	25.38
2012	59	22	16	41	18	6	65	24.64/30.4

* Numbers after slash means the number of months taken for MAP with non-OECD countries.

1. Number of New Cases

As is the general trend in other OECD countries, MAPs are generally underused in Korea as well. The number of MAP cases seems to be fairly low compared to the amount of international trade and investments involving Korea. For new cases initiated in 2007, only one case was resolved in the same year. Of the new cases initiated in 2006, none was resolved in the same fiscal year. The data do not show the number of cases closed without resolution, but, according to a transfer pricing advisor, there was at least one such case, which means that there are cases that came out without resolution. Unfortunately, the above data are not sufficient to draw any consistent pattern of cases in terms of the number of cases resolved compared to those initiated, the number of months it took to resolve cases, and the increase or decrease in the number of transfer pricing cases, etc.[198]

Korea hosted the third Meeting of Global Forum on Tax Administration[199] in mid-September of 2006. As a follow up of the successful Meeting, the NTS actively sought resolution of then pending MAP cases as part of the strategic "tax foreign diplomacy," which resulted in the resolution of 13 cases in just less than 4 months from the end of September to the end of that year. This strategic drive by the NTS to resolve the MAP cases was reflected in the total number

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[198] Despite the author's effort to obtain further data from the Korean tax authority the information sought was confidential and could not be disclosed. The only recourse to the unavailability of the data would be to wait until the OECD accumulates the data in the coming years so that the academics can analyze them through empirical studies.

[199] The Forum on Tax Administration was created in July 2002 by the Committee on Fiscal Affairs with the aim of promoting dialogue between tax administrations and of identifying good tax administration practices. The first meeting was officially launched in January 2004 in Seville, Spain.

cases completed in 2006 being higher than other years. Therefore, the data for 2006 may be a bit skewed for comparison with other years. Excluding 2006, the average number of cases completed each year is 11 cases while the number of new cases is 18, implying that back logs are accumulating each year.

2. Average Processing Time

More than half of disputes submitted to Korea's MAPs are resolved within two years and about 25% of disputes are resolved within four years. In the OECD publication, the average processing time in Korea is 19 to 24 months for the years from 2006 to 2009. However, this average is misleading because the calculation excludes cases that are older than three years. For example, for 2006, the average processing time was 22 months but the calculation included the cases initiated in or after 2003. There were 18 other cases that were initiated before 2003 but completed in 2006 and these cases were not taken into account for the purpose of calculating the average processing time. 2006 was perhaps abnormal because of the NTS's drive for the Global Forum on Tax Administration held in Korea in 2006, but the calculation remains to be misleading for all other years. This means that the actual average processing time is highly likely to be longer than the average processing time published by the OECD.

Also, most MAP cases are submitted after the tax authorities have conducted field audits and made tax assessments. Field audits are performed for the years that remain open for the purpose of statute of limitation, which is 5 years in Korea. By the time the matters are settled by the competent authorities, if taxpayers choose to seek competent authority procedure on the matters that they

think resulted in double taxation, it could well be close to 10 years from the time the original tax returns have been filed. This is a significant period of uncertainty on the part of taxpayers.

3. Number of Completed Cases

It was discussed briefly that not all MAP cases are resolved, according to an informal conversation with a professional advisor. Furthermore, the fact that a case was resolved does not mean that it had a "fair" outcome. For example, in a transfer pricing case, the competent authorities may agree on an arm's length price which suits them both but deviates substantially from the "true" arm's length price, forcing the taxpayer to pay more taxes than a truly arm's length amount. Furthermore, even where statistical data show that all cases are resolved, it does not mean that the fiscal authority accepted all MAP requests from taxpayers. In fact, many taxpayers voluntarily give up on initiating the MAP, presuming that the Korean tax authority would not agree to proceed with the case, and such presumption cannot be said to be groundless in the Korean tax practice. In fact, some cases are ipso facto rejected by the Korean tax authority, but there is no statistical information on this point because taxpayers typically consult unofficially with the Korean tax authority before they formally submit MAP applications and would not request a MAP unless, to the mind of the taxpayer, the Korean tax authority will accept such request.

4. Comparison between MAP v. APA

Table 4 shows a comparison between Advance Pricing Arrangements ("APA") and MAP cases.[200] At least in transfer pricing cases, a bilateral APA, an ex-ante agreement among the two competent authorities and a taxpayer, is an alternative to the ex-post MAP. The average time that APAs took to settle was 30 months as opposed to 22 to 24 months for MAP cases. However, as discussed above, the average processing time for MAPs as published by the OECD is misleading because older than three year cases are excluded in calculating the average processing time, therefore, the actual time taken for MAPs is likely to be longer than the average time published by the OECD. As such, it seems that an adequate comparison of the average processing times cannot be made between MAPs and bilateral-APAs. In terms of number of cases, Korea follows the global trend of the rise in the number of APAs, but it is pre-mature to conclude whether the number of MAP cases is decreasing.

<Table 6: MAP v. APA in Korea>

Korea	Opening Inventory		New Cases		Completed Cases		Ending Inventory		Average Processing Time (# of months)	
	Bi-APA	MAP	Bi-APA	MAP	Bi-APA	MAP	Bi-APA	MAP	Bi-APA	MAP
2006	29	48	12	8	16	28	25	28	33	22
2007	25	28	13	9	7	7	31	30	17	24

[200] Bilateral advance pricing agreements ("BAPA"s) are conducted by mutual agreements between the two competent authorities. The BAPA is an example of how the MAP can be a practical and appropriate way to come to an agreement about transfer pricing issues; the Korean tax authority seems to encourage such movement as shown on the APA Annual Reports published by the NTS which contains outlines of how taxpayers benefit from the APAs. This is also consistent with taxpayers' opinion that the MAP is better equipped to resolve transfer pricing cases and less equipped to resolve non-transfer pricing cases. *See* Altman, *supra* note 4, at 127.

2008	31	30	22	13	14	13	39	30	27	21
2009	39	30	21	25	7	8	53	47	14	19
2010	53	47	25	13	10	16	68	44	27	22
2011	68	44	30	24	13	8	85	59	27	25
2012	-	59	-	22	-	16	-	65	-	25

* Information for BAPA was extracted from the *APA Annual Reports*, which are published annually by the National Tax Service of Korea.

Global data in this area are scarce, but some data were available on the number of Bi-APA and MAPs in Japan.

<Table 7: MAP v. APA in Japan>

Japan	Opening Inventory		New Cases		Completed Cases		Ending Inventory		Average Processing Time (# of months)	
	Bi-APA	MAP	Bi-APA	MAP	Bi-APA	MAP	Bi-APA	MAP	Bi-APA	MAP
6.2007	170	67	105	49	84	31	191	85	n.a.	n.a.
6.2008	191	85	113	40	82	43	222	82	n.a.	n.a.
6.2009	222	82	130	44	91	36	261	90	n.a.	n.a.
6.2010	261	90	149	34	105	49	305	75	n.a.	n.a.
6.2011	305	75	135	22	128	36	312	59	n.a.	n.a.
6.2012	312	59	112	22	135	22	289	70	n.a.	n.a.
6.2013	289	70	131	36	129	41	291	65	n.a.	n.a.

*Information on BAPA was extracted from the *APA Program Report*, published by the National Tax Agency, Office of Mutual Agreement Procedures of Japan. The most recent report is available at http://www.nta.go.jp/kohyo/press/press/2013/sogo_kyogi/index.htm, which was last viewed on November 3, 2013.

The number of APA cases is also increasing in Japan, in line with the global trend, while the number of MAP cases is decreasing. The trend of MAP cases

decreasing in number is more noticeable in Japan than Korea. Unfortunately, information on average processing time is not available. Overall, the number of APA cases seems to be increasing in both Korea and Japan which is consistent with the observation made in the E&Y Transfer Pricing Reports.[201]

D. Allocation v. Non-Allocation Cases

1. In General

The OECD gathered statistics on the number of allocation cases vis-a-vis non-allocation cases and the number of cases successfully closed for each type for the purpose of determining whether the MAP works better for allocation cases compared to non-allocation cases. Unfortunately, many countries did not provide specific information, and there was not enough data available to draw any meaningful conclusions.

Also, each country seemed to have given a slightly different meaning to the term "allocation." For example, the Netherlands used the term transfer pricing and non-transfer pricing to differentiate allocation cases from non-allocation cases. Switzerland noted that it included Article 9 cases in allocation cases. Article 9 of the OEC Model Tax Treaty is a provision on adjustments of affiliated companies, therefore, Article 9 cases seem to be transfer pricing cases. The scope of allocation v. non-allocation is not clear, however. For example, in

[201] However, in terms of absolute number of cases, Japan has a noticeably larger number than the number of cases in Korea for both bi-lateral APAs and MAPs. One of the reasons for such difference could be that the Japan's economy is larger than the Korean economy in general, and that Japan has more business and investment activities with foreign investors compared to Korea. Nonetheless, it would be interesting to research the exact reasons for the difference.

a case involving a German company operating in Korea without formally establishing a subsidiary or a branch, the NTS nevertheless decided that the Korean local operation of the company constituted a permanent establishment. In the mutual agreement following the NTS action, the two competent authorities agreed to give 60% of the profit to manufacturing (i.e. to Germany) and 40% to marketing and distribution (i.e. to Korea). The question remains as to whether this would be an allocation case because this case does not seem to fall under Article 9 or transfer pricing in a strict sense; rather it seems like an allocation of income case. In the end, it is not quite clear what is included as allocation cases or non-allocation cases for each country.

<Table 8: Processing Time for TP and Non-TP cases[202]>

	Period	Proportion of cases		Average Processing Time (# of months)	
		TP	Non-TP	TP	Non-TP
Korea	2005 ~ 2007	70%	30%	30[203]	21
US	1995 ~ 2005	60%	40%	27.6	21.6
Australia	1999 ~ 2006	66%	34%	26	36
Canada	2001 ~ 2004	52%[204]	48%	n.a.	23.7
Japan	2001 ~ 2003	58%	42%	n.a.	n.a.

[202] The data for the Table 8 come from various sources including: Org. of Econ. Co-Operation & Dev. [OECD], *Country Mutual Agreement Procedure Statistics* (Dec. 28 2011), *available at* http://www.oecd.org/document/20/0,3746,en_2649_37989739_48558740_1_1_1_1,00.html (last visited January 30, 2012); Altman, *supra* note 4; and Burnett, *supra* note 159, note 28.

[203] No data is available for the average case length for transfer pricing MAP cases. For the purpose of the table, 30 months represents the average time taken for APAs.

[204] For Canada, transfer pricing cases take up for 66% of negotiable cases, which is about 48% of total MAP cases. The author took out the portion of withholding tax case, which accounted for roughly 40% of the total number of cases and recalculated the proportion of transfer pricing cases, which came out be approximately 52%, which is consistent with the global trend seen in other countries. The withholding case was a case of U.S. taxpayers asking for a refund of tax without involving the U.S. tax authority.

The Netherlands	2006 ~ 2007	34%	66%	n.a.	n.a.

2. Country Specific Statistics for TP and non-TP Cases

The following table summarizes statistics of TP cases and non-TP cases for selected countries.

<Table 9: Number of TP v. Non-TP Cases for Selected Countries>

Japan	Opening Inventory		Received		Disposed		Ending Inventory	
	A	NA	A	NA	A	NA	A	NA
6.2009	57[205]	25	30	14	23	13	64	26
6. 2010	64	26	27	7	33	16	58	17
6. 2011	58	17	14	8	27	9	45	16
6.2012	45	16	21	10	15	7	51	19
6.2013	51	19	30	6	33	8	48	17
Total			122	45				

* The information was obtained from the MAP Report as published by the National Tax Agency of Japan. A refers to allocation cases and NA refers to non-allocation cases.

The Nether-lands[206]	Opening Inventory		Received		Disposed		Ending Inventory	
	A	NA	A	NA	A	NA	A	NA
2006	38	58	25	55	26	30	37	83
2007	37	83	30	27	10	16	57	94
Total			55	82				

[205] Opening inventory of 2009.6 was not available but it was possible to calculate it as all other numbers were provided in the report.

[206] Allocation cases mean transfer pricing cases while non-allocation cases mean interpretation cases according to the country reports to the OECD. The Netherlands reported the number of allocation cases and non-allocation cases in 2006 and 2007 only.

Switzer-land[207]	Opening Inventory		Received		Disposed		Ending Inventory	
	A	NA	A	NA	A	NA	A	NA
2008	15	0	40	59	9	20	49	39
2009	49	39	31	88	17	47	63	80
Total			71	147				

US	Opening Inventory		Received		Disposed		Ending Inventory	
	A	NA	A	NA	A	NA	A	NA
1997			124	55	104	51	254	109
1998			83	62	125	58	212	113
1999			93	67	110	73	195	107
2000			92	78	84	44	203	141
2001			113	66	83	72	233	125
2002			94	57	104	69	223	113
2003			96	74	91	66	228	121
2004			86	66	101	67	213	118
			781	525				

* The information was extracted from Altman, *supra* note 4, at 121-25.

Australia	Opening Inventory		Received		Disposed		Ending Inventory	
	A	NA	A	NA	A	NA	A	NA
7/1999 ~6/2001	37	2	13	6	19	2	-	-
7/2001 ~6/2006	-	-	43	13	48	11	-	-
Total			57	19	67	13		

[207] Switzerland's country reports include Article 9 cases and cases for other than Article 9. Article 9 being Associated Enterprises, the author assumed that it would be allocation cases. Switzerland stopped reporting the number of Article 9 cases from 2010.

* The information was extracted from Burnett, *supra* note 161.

Unfortunately, statistics for Korea was not available. However, in terms of number of transfer pricing and non-transfer pricing cases, there is a definite trend that transfer pricing cases take up more than an half of total MAP cases. Altman attributed the reason for this phenomenon to taxpayers' opinion that the MAP is better equipped to resolve transfer pricing cases and less so for non-transfer pricing cases.[208]

E. Sub-Conclusion

No coherent data

With the inconsistent data limited to a few specific countries, it is difficult to draw meaningful conclusions about whether taxpayers regard the MAP as satisfactory dispute resolution mechanism for resolving their international tax disputes. Absent the data regarding the number of tax audits, appeals from the audit results, litigations and other related information, conclusion cannot be drawn whether the MAPs are under-utilized in Korea and in any other country. Even the E&Y Transfer Pricing Study is not quite comprehensive either. Nonetheless, attempted below is intuitional and anecdotal attempt to infer from the limited data some conclusions about the number of MAPs and processing time.

Number of MAPs

[208] Altman, *supra* note 4, at 128.

In terms of the numbers, MAPs seem to be underused. The statistics show that the number of MAP cases is low compared to the size of the international trade and investments. Fiscal authorities also agree that MAPs are not utilized fully, as discussed above. E&Y Survey corroborates such position that MAPs are underused.

Judging from the absolute number of MAP cases, MPAs appear to be under-used in Korea as well consistent with the OECD Statistics. Reasons for such under–utilization are: (i) the NTS is a difficult government agency to deal with; (ii) the NTS does not accept all cases, and taxpayers actually pursue a MAP only after they first obtained an unofficial green signal from the NTS through their tax advisors, effectively creating an informal filtering process; and (iii) NTS may not have enough resources to accept all MAP applications.

Processing Time

In terms of average processing time, no conclusion can be drawn whether transfer pricing cases take longer to resolve than non-transfer pricing cases or vice versa. The OECD statistics do not provide separate information on the average processing time for allocation and non-allocation cases. Furthermore, available literature provides conflicting findings.

For Australia, however, there is a report indicating that the non-transfer pricing MAPs took an average of three years while transfer pricing MAPs took 2.16 years (26 months) for the years from 1999 to 2006.[209] On the other hand,

[209] Burnett, *supra* note 159, at 177. Burnett tried to seek the reason for this difference in the different nature of cases, i.e., because non-transfer pricing cases involve the positions that

Altman observed the opposite phenomenon in the U.S. The average processing time for transfer pricing cases (referred to as allocation cases in the original text) was about 2.3 years (27.6 months) from 1995 to 2005, while non-transfer pricing cases had an average processing time of about 1.8 years (21.6 months). However, note that the U.S. has total of 657 new allocation cases during a 7 year period and 470 non-allocation cases while Australia has 57 and 19 new cases, respectively.[210] The fact that allocation cases took 2.3 years for the U.S. means that the same cases also took 2.3 years for the counter-parties. Since the number of MAP cases of the U.S. far exceeds that of Australia, it can be cautiously said that allocation cases generally take longer than non-allocation cases. However, with the information on these two countries only, it would be too premature to draw any conclusions in terms of the average processing time.

MAP for transfer pricing cases?

Apparently, the global trend is that the number of transfer pricing cases exceed that of the non-transfer pricing cases, though there is a country specific variance such as the Netherlands or Switzerland.[211] Altman attributed the reason for this phenomenon to the taxpayer's perception that the MAP is better equipped to

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countries take on treaty law and tax policy, some of which are presumably firmly held, non-transfer pricing cases are more difficult to settle than the transfer pricing cases, which involve factual and numerical apportionment.

[210] For the US, the author added the number of cases from 1998 to 2004 as there was no information available for post-2005. For Australia, the 7 year period runs from fiscal year 2000 to 2006. This is not an exact match in terms of when the 7 year period begins, but the two year difference does not seem to create a meaningful discrepancy.

[211] It was shown already that transfer pricing disputes probably top the list of treaty controversies that concern multinationals in the U.S. According to an informal interview with a former NTS officer, the number of transfer pricing cases greatly exceeds the number of non-transfer pricing cases in Korea also.

resolve transfer pricing cases and less equipped to resolve non-transfer pricing cases,[212] i.e., allocation cases may more easily be resolved through a buck-to-buck negotiation while other lumpier types of disputes may require a different dispute resolution mechanism closer in nature to adjudication. [213] Also, Burnett notes that non-allocation cases are more difficult to settle than allocation cases because non-allocation cases involve the positions that countries take on treaty law and tax policy, while allocation cases involve factual material and numerical apportionment.[214] In fact, Burnett noted that bi-lateral APAs are an example of how mutual agreement can provide a practical and appropriate way to come to an agreement about transfer pricing issues.

III. Alternatives to MAP

Because the MAPs do not require the competent authorities to reach an agreement, which is a rather significant problem recognized even by the OECD itself, the Pre-2008 Commentaries on the Articles of the OECD Model Tax Convention ("OECD Commentaries") suggested two methods that would supplement the MAP, which are advisory opinion and arbitration.[215] However, with the mandatory arbitration inserted in the OECD Model Tax Convention now, the 2008 OECD Commentaries recommend two supplementary dispute resolution mechanisms; mediation and third party opinion. Resorting to domestic courts for resolving tax disputes is always an option open to all

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[212] Altman, *supra* note 4, at 127.
[213] *Id.*, at 287-88.
[214] Burnett, *supra* note 159, at 177.
[215] Pre 2008 OECD Commentaries on Article 25, Paragraph 45-48, which was eliminated with the introduction of mandatory arbitration clause in July 2008, conceded that the MAP alone is insufficient and that other approaches should be taken from outside the framework of the MAP.

taxpayers. Furthermore, there is a procedure available only in the EU which allows national courts to seek preliminary rulings from the European Court of Justice ("ECJ"). This preliminary ruling procedure is not limited to tax law area, but is available for interpretation of all EU laws and regulations. Nonetheless, taxpayers in Europe can take their international tax issues to domestic courts, which in turn can seek preliminary rulings from the ECJ. This section discusses each of the three alternative methods of resolving international tax disputes briefly.

A. Mediation

A number of countries have a procedure where a case is reviewed by a person who has no direct connection with the case in an effort to "mediate" and clarify the positions of the two parties. A mediator listens to the positions of each party and then communicates a view of the strengths and weaknesses of each side, which helps each party to better understand its position and that of the other party.[216]

B. Third party opinion

The OECD Commentaries suggest seeking an opinion of an impartial third party, particularly for factual matters.[217] The pre-2008 OECD Commentaries suggested seeking an advisory opinion, although the final decision would still rest with the States, or an opinion of the Committee on Fiscal Affairs of the

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[216] *See in general* OECD Commentaries, para. 86. *See also* Hugh J. Ault, *Improving the Resolution of International Tax Disputes*, 7 FLA. TAX REV. 137, 143 (2005).
[217] *See in general* OECD Commentaries, para. 87.

OECD. The pre-2008 OECD Commentaries contemplated that a technical opinion should be sought with respect to interpretation of treaties.[218] With the revision in 2008, the current OECD Commentaries contemplate a third party acting to draw an agreement from the parties on factual disagreements. It is not clear what caused this shift in the OECD's recommendation, but perhaps it reflects the fact that there has not been a case where the parties sought a technical opinion from the Committee on Fiscal Affairs

C. Domestic Court

Taxpayers can resort to domestic courts for issues arising out of treaties. However, there are a number of issues that foreign taxpayers are concerned with in relation to the use of domestic courts for resolving tax disputes:

- Domestic courts can only provide a one-sided solution, without proper coordination with the taxation in the other country;
- It takes long time;[219]
- It is costly for taxpayers and tax administrations.[220] Legal access to foreign courts is much more expensive for taxpayers, given their unfamiliarity with the local laws, culture, language, communication and procedures, as well as travelling expenses involved.[221]
- Cases tend to be very fact specific, which lengthens the litigation process;

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[218] Altman, *supra* note 4, note 34, at 143.

[219] It generally takes about 2 to 3 years to complete a litigation assuming the cases will be appealed all the way to the Supreme Court in Korea.

[220] *Commission Staff Working Paper*, *supra* note 73, at 275.

[221] Legal cost almost doubles for foreign taxpayers litigating in Korea due to the extensive translation and communication work involved, particularly when the foreign taxpayers' legal counsels are not tax experts.

- Domestic courts may not be impartial when dealing with foreign taxpayers for the reasons of nationalism, corruption, outside influences (public sentiment), politics, court being part of the same government, etc.;[222]
- Domestic judges may not be knowledgeable and experienced enough with international tax matters to provide adequate decisions;[223]
- The use of domestic courts cannot generate general international guidance on the application of tax treaties. Different domestic legal systems may cause conflicting interpretations on identical treaty languages, which would increase the transaction costs for taxpayers who design their international tax structures by requiring them to be familiar with the legal interpretations of each jurisdiction in which they operate.
- Given the confidentiality of many tax cases, and the limited publicity that domestic decisions have, domestically and internationally, there is little pressure on the reputation of domestic courts to comply with their government's international obligations. Domestic courts may therefore feel free not to take into consideration the international relations implications of their decisions.

Preliminary Ruling Procedure in EU

A domestic court of EU member nation can request (or reference) for a preliminary ruling by submitting questions, along with the circumstances under

[222] Burnett, *supra* note 159, at 177.
[223] Pre 2008 OECD Commentaries on Article 25, Paragraph 45-48, which was eliminated with the introduction of mandatory arbitration clause in July 2008, conceded that the MAP alone is insufficient and that other approaches should be taken from outside the framework of the MAP.

which the questions arose, to the ECJ for resolution.[224] A preliminary ruling, which is a decision of the ECJ on the interpretation of European Union law,[225] is a de facto final determination of the law in question. Even though the ECJ is limited to deciding the law in question, because such decision is based on the facts and circumstances provided at the time of request, the ECJ's ruling frequently becomes the decision of the court which initially sought the ruling. The ECJ may also decline to render a judgment in the absence of a genuine dispute.[226]

The EJC's authority to render preliminary rulings comes from the Treaty on the Functioning of the European Union which allows and sometimes requires the court or a tribunal to exercise such authority when faced with the request to interpret treaties or the acts of the institutions, bodies, offices or agencies of the European Union.[227] The demand for ECJ is growing with more than 1,300 cases filed at the ECJ in Luxembourg in 2008.

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[224] The European Court of Justice (officially the Court of Justice) is the highest court in the European Union on matters involving European Union law. As part of the *Court of Justice of the European Union* institution, it is tasked with interpreting EU law and ensuring its equal application across all EU member states.[1] The Court was established in 1952 based in Luxembourg. It is comprised of one judge per member state — currently 27 — although it normally hears cases in panels of three, five or thirteen judges. The court has been led by President Vassilios Skouris since 2003.

[225] European Union law (historically called the "European Community law") is a body of treaties and legislation, such as the Regulations and Directives, which have direct effect or indirect effect on the laws of the European Union member states. The three sources of European Union law are the primary law, the secondary law and the supplementary law. The main sources of the primary law are the Treaties establishing the European Union. The Secondary sources include regulations and directives which are based on the Treaties. The legislature of the European Union is principally composed of the European Parliament and the Council of the European Union, which under the Treaties may establish secondary law to pursue the objective set out in the Treaties.

[226] Case 244/80, Foglia v. Nuvello. 1981 E.C.R. 3045

[227] Treaty on the Functioning of the European Union, The European Union, Art. 267, Sept. 5, 2008, C 115/47.

CHAPTER 3. FRAMEWORK FOR ANALYSIS OF TAX TREATY ARBITRATIONS

I. Introduction

Even though there is no record of the arbitral institutions handling arbitration of international tax disputes arising under bilateral tax treaties,[228] the idea of international tax arbitration has a long history. The use of arbitration (and/or the use of some form of international tax tribunal) in resolving international tax disputes was recommended as early as at the end of the 19th century by a German scholar named Ludwig von Bar[229]. It was also briefly discussed in Chapter 2 that the early reports by the Committee of Economic Experts as well as the Committee of Technical Experts of the League of Nations mentioned the possibility of arbitration as a way to resolve international tax disputes.

However, it was not until 100 years later that the arbitration was integrated for the first time in the bilateral tax treaty between the U.S. and Germany signed in 1989.[230] Though there have been discussions intermittently throughout the period, international tax arbitration, as an institution, is very much in its infancy. Since then more bilateral treaties with an arbitration clause have been signed mostly by the U.S.,[231] the Netherlands and Canada, but only the treaty between Sweden and Germany had a mandatory arbitration provision,[232] and the other

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[228] The ICSID handled a few tax cases under the investment treaties, however, those cases were primarily "expropriation" cases, which merely deal with the issue of whether the act of the State amounted to "expropriation" as defined in the relevant investment treaty.
[229] Altman, *supra* note 4, at 18, 75.
[230] *Id.*, at 19.
[231] *Id.*, at 21 (providing that more than 50 treaties have incorporated an arbitration provision).
[232] *Id.*, at 22 n.81.

treaties required consent by the competent authorities one way or the other.[233]

Advocates of arbitration emphasize that arbitration can fix some of the problems of the MAP. However, as long as arbitration resides within the MAP, it will always be limited by the boundary of the MAP. Nonetheless, international tax arbitration even in a limited form may be desirable because taxpayers are able to get some comfort in the fact that there is an alternative to, or at least a complementary structure to, a MAP. Further, apart from being desirable or not, the development of international tax arbitration seems inevitable these days as more countries, particularly the U.S. and a few European countries with strong influence on the global economy, are pushing towards the incorporation of arbitration provisions in tax treaties.

There seems to be no evidence of any arbitration having been conducted under the arbitration provisions of a bilateral tax treaty. Reportedly, only three cases were referred to arbitration under the EU Transfer Pricing Arbitration Convention.[234] However, with the increasing number of disputes in the area of international tax and corresponding time delays and frustrations associated with the MAP, arbitration is gaining more attention as a way of encouraging satisfactory settlements and mutual agreements at this time.

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[233] The Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises was signed in 1990 by twelve European countries (referred to as the "1990 European Transfer Pricing Convention" or "EC Arbitration Convention"), and it includes a mandatory arbitration provision to refer an unresolved dispute over transfer pricing to an Advisory Commission. The author defers to a later opportunity to further explore the contents of this Convention. *See* Züger, *supra* note 158, at 65-66.

[234] *Commission Staff Working Paper*, *supra* note 73, at 272.

Some tax treaties already contemplated that the parties might perhaps agree to resolve disputes through arbitration. For example, the 1989 U.S.-German Income Tax Treaty before the revision adopted by the 2006 Protocol provided, "If a disagreement cannot be resolved by the competent authorities it may, if both competent authorities agree, be submitted for arbitration. The procedures shall be agreed upon and shall be established between the Contracting States by notes to be exchanged through diplomatic channels."[235] The OECD also suggests post-dispute arbitration agreement when the governments have not yet included an arbitration provision in the treaty.[236] The willingness to agree on arbitration is a step forward, but the post-dispute nature of such arbitration imposes no obligation on the competent authorities, and therefore, it may not be so practical, particularly when the two competent authorities have already failed to reach an agreement after arguing for two years. Instead, if an agreement to arbitrate, or a legally binding mechanism to resolve international tax disputes, were agreed upon and built into the tax treaty, a much more reliable and workable system could be achieved. The 2006 Protocol to the tax treaty between the U.S. and Germany is probably a good example of adopting such pre-dispute mandatory arbitration, though no arbitration has taken place yet under this 2006 Protocol.

In 2008, the OECD introduced a mandatory arbitration in the OECD Model Tax Convention in response to the needs of taxpayers and business community. The arbitration provision as introduced by the OECD in 2008 envisages pre-dispute mandatory agreement to arbitrate, though its mandatory nature is somewhat

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[235] Article 25(5) of the U.S. - Germany Tax Treaty signed in 1989 and became effective in 1991. The 2006 Protocol revised a substantial portion of the 1989 Treaty.

[236] 2010 OECD Model Tax Convention, *supra* note 116, Commentary to Article 25, Para. 69.

tarnished, as will be discussed below in detail under Chapter 4, Part II. Sec. A. In this Chapter, the historical development of commercial arbitration to the extent it might be germane as a frame of reference for analyzing tax arbitration is briefly reviewed in Part II, analysis of the EU Transfer Pricing Arbitration Convention is in Part III, and three examples of tax arbitration cases in Part IV before reviewing the tax arbitration clause proposed by the OECD in 2008 in Chapter 4.

II. Development of Arbitration in Commercial and Governmental Disputes

In the history of tax treaties, the idea of arbitration was competing with the MAP as a dispute dissolving mechanism and the ICC in the 1920s was still endorsing arbitration. Arbitration, however, became dormant from the 1940s while the actual tax treaties uniformly adopted the MAP, until the early 21st century when the OECD revived the idea. Unlike the tax treaties, the arbitration idea continued to get momentum in commercial disputes all through these years.

The Geneva Protocol of 1923 [237] was the first modern and genuinely international[238] arbitration convention which was drawn up on the initiative of the ICC and under the auspices of the League of Nations. Its main purpose was to ensure that arbitration clauses were enforceable internationally, especially in the State in which the award was made. Then, the Geneva Convention of

[237] The full name is "Protocol on Arbitration Clauses."
[238] There were regional conventions, such as the Convention for the Pacific Settlement of International Disputes of 1899. *See* the list of international conventions at Georgios Petrochilos, Procedural Law in International Arbitration, Oxford Private Int'l Law Series, vat xix (2004).

1927[239] broadened the scope of the 1923 Geneva Protocol by providing for the recognition and enforcement of awards within the territory of any of the contracting States, rather than merely within the State in which the award is made. The New York Convention of 1958,[240] again at the proposal of the ICC, was drawn up by the United Nations,[241] and it operated, with its simple and effective method of obtaining recognition and enforcement of foreign arbitral awards, to promote recognition of arbitration agreements and awards in 146 signatory countries,[242] including Korea which signed to it in 1973. The New York Convention, which is said to be the most influential on the development of international arbitration,[243] replaced the 1927 Geneva Convention.

There are numerous institutions around the world which administer international arbitrations. The ICC is one of the world's leading arbitration institutions in terms of international investment disputes. The International Court of Arbitration is the administrative body for ICC arbitrations.[244] London Chamber of Arbitration started in 1883 as a local institution, but has grown to be an international institution, particularly when it appointed a non-English

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[239] The full name of the 1927 Convention is the "Convention on the Execution of Foreign Arbitral Awards."

[240] The full name of the New York Convention is the "Convention on the Recognition and Enforcement of Foreign Arbitral Award."

[241] It is also commonly called the "UN Arbitration Convention."

[242] *Available at* http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html (last visited March 10, 2012).

[243] See *Redfern and Hunter on International Arbitration*, Oxford University Press, 634 (2009) (commenting that "the Convention has been recognized as the 'single most important pillar on which the edifice of international arbitration rests' and as a convention which perhaps could lay claim to be the most effective instance of international legislation in the entire history of commercial law."); *see also infra*, Ch. 4, Part III, Sec. D for further discussion on the recognition and enforcement of arbitral awards.

[244] *Id.*, at 60.

Director General recently and formed an international court.[245] In the U.S., the International Centre for Dispute Resolution within American Arbitration Association, established in 1996, serves as an institution to handle international arbitrations, but due to its relatively short history, arbitrators tend to have less experience than other more established arbitral institutions. The WIPO (World Intellectual Property Organization) Arbitration Centre is specialized in arbitrating disputes related to intellectual property issues.

Arbitration gained momentum not only in the commercial or private disputes, and began extending to disputes involving sovereign states. The Washington Convention of 1965,[246] formulated by the World Bank, led to the establishment of the International Centre for Settlement of Investment ("ICSID") to facilitate the resolution of international investment disputes and promote foreign investment. The Washington Convention broke new ground by allowing private individuals and corporate investors in a foreign State the right to bring legal proceedings against that State before an international arbitral tribunal. Today, the ICSID is considered to be the leading international arbitration institution devoted to investor-State dispute settlement.

While the aforementioned ICC and other commercial institutions primarily handle disputes between private persons as parties, two arbitral institutions, the ICSID in Washington and the Permanent Court of Arbitration (the PCA) in

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[245] International Arbitration Handbook, Taepyungyang Law Office, ICC Arbitration, at 95. (국제중재핸드북, 법무법인(유) 태평양, ICC 중재편). The LCIA's court consists of up to thirty five members of whom no more than six may be of UK nationality; *See for more information* http://www.lcia.org/LCIA/Organisation.aspx (last visited January 30, 2012).

[246] The full name of the Washington Convention is the "Convention on the Settlement of Investment Disputes between States and Nationals of Other States" and it is also called the "ICSID Convention."

Hague, usually handle disputes that involve a State or a State entity as a party to arbitration.[247] The ICSID is an autonomous international institution established under the Washington Convention with over one hundred and forty member States, which entered into force in 1966. The primary purpose of ICSID is to provide facilities for conciliation and arbitration of international investment disputes.[248, 249] The PCA, born as a result of The Hague Peace Conference in 1899, is an intergovernmental organization with over one hundred member states, established in 1899 to facilitate arbitration and other forms of dispute resolution between states. Arguably, the ICSID and PCA laid the foundation to tax arbitration in that the idea of arbitration can well extend to sovereign governments and public law disputes.

In terms of the arbitration rules, despite the tendency for each arbitral center to have its own set of rules, the Model Law of the United Nations Commission on International Trade Law ("UNCITRAL")[250] is used most widely, particularly by newer arbitration centers.[251] The UNCITRAL adopted the first Model Law on International Commercial Arbitration ("Model Law") in 1985, which was revised in 2006. It covers all stages of the arbitral process, from the arbitration agreement, the composition and jurisdiction of the arbitral tribunal, to the

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[247] Redfern, *supra* note 243, at 64.

[248] http://icsid.worldbank.org/ICSID/ICSID/AboutICSID_Home.jsp (last visited January 30, 2012).

[249] Korea never had investor- state dispute ("ISD") claims by foreign investors until last year when, on Nov. 21, 2012, Lone Star Funds, the Dallas-based private equity firm, filed ISD arbitration claims at the ICSID against the Korean government. See *infra* Ch.3, Part IV for details on Lone Star case.

[250] UNCITRAL is the core legal body of the United Nations in the field of international trade law. One of the main objectives of UNCITRAL is to modernize and harmonize the rules on international business. A model law is a legislative text that is recommended to States for enactment as part of their national law.

[251] Redfern, *supra* note 243, at 58.

recognition and enforcement of the arbitral award. The Model Law is adopted by 66 countries as of the end of 2011.

III. EU Transfer Pricing Arbitration Convention

Arbitration became an institutionalized dispute resolution system in the 1990s, albeit limited in the territorial context of the EU and further limited in its subject matter of transfer pricing. In an attempt to eliminate double taxation in connection with profit adjustments among associated enterprises, the European Union in 1990 adopted a Transfer Pricing Convention ("EU Transfer Pricing Arbitration Convention"). The EU Transfer Pricing Arbitration Convention applies when profits are included in the income of more than one Contracting State by reason of allocations among related taxpayers in order to reflect arm's length conditions. States that signed the Convention can invoke the MAP under a bi-lateral tax treaty or the Convention. The major advantage of invoking the EU Transfer Pricing Arbitration Convention is the time frame it involves. The Convention prescribes a specific time frame as to what needs to be done so that a dispute can be resolved effectively in three years, including the second step of arbitration. Also, because the Convention forces the competent authorities to resolve taxpayers' issues involving double taxation, but not necessarily the correct application of the treaty or domestic laws, taxpayers are in a better position to be relieved from double taxation, which often remains unresolved in many transfer pricing cases. However, as the name suggests, the EU conventions are only available to persons who reside in EU. The EU Transfer Pricing Arbitration Convention, though its scope is limited to transfer pricing cases and to EU residents, is similar to Article 25 of the OECD Model Tax Convention as revised in 2010 in that it allows taxpayers to invoke a MAP

and arbitration for international tax disputes. Having existed for two decades now, the EU Transfer Pricing Arbitration Convention offers an insight into the MAP, which can be used as a frame of reference for evaluating the newly revised Article 25 of the OECD Model Tax Convention.

Comparison of the EU Transfer Pricing Arbitration Convention and the OECD Model Tax Convention entails some inherent limitations because the EU Transfer Pricing Arbitration Convention is limited to transfer pricing cases. Despite the difference, however, the basic concept is the same, i.e., after the two year period of the MAP, the relevant case is to be referred to arbitration. Furthermore, because the related procedural rules are similar, studying the EU Transfer Pricing Arbitration Convention would enable one to (1) compare how the arbitration system under the OECD Model Tax Convention differs from the one under the EU Transfer Pricing Arbitration Convention and (2) analyze whether the arbitration as offered by the OECD Model Tax Convention can be improved based on the EU Transfer Pricing Arbitration Convention, or vice versa.

A. Background

The origin of the EU Transfer Pricing Arbitration Convention[252] was (1) the Commission's[253] 1976 proposal for a directive to eliminate double taxation in

[252] The official name of the convention is the "Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises."

[253] The EU is an economic and political partnership of 27 European countries created after the World War II. EU legislation is generally drafted by the EU Commission and approved by the European Parliament together with the EU Council (the governments of the 27 EU countries). The EU Commission proposes legislative acts for the European Parliament and the Council of Ministers to adopt. The EU Commission is also responsible for putting the EU's common

the case of transfers of profits between associated enterprises in different Member States;[254] and (2) the White Paper of 1985 on the completion of the Internal Market. After long negotiations in the Council, the Commission's proposal was transformed from a Directive into an inter-governmental Convention signed on 23 July 1990,[255] and effective 1995, now with automatic five year extensions, unless expressly terminated.[256]

The EU Transfer Pricing Arbitration Convention is effective at eliminating double taxation among EU member states in the transfer pricing context. In most bilateral double taxation treaties, when there is an upward transfer pricing adjustment in one State, a corresponding downward adjustment is made on the profits of the associated enterprise in the other State. However, these bilateral tax treaties do not generally impose a binding obligation on the contracting states to eliminate the double taxation. In comparison, the EU Transfer Pricing Arbitration Convention provides for elimination of double taxation by agreement between the contracting states and, if necessary, by reference to the opinion of an independent advisory body. Furthermore, the Code of Conduct for the EU Transfer Pricing Arbitration Convention ("Code of Conduct") provides

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policies (like the common agricultural policy and the growth and jobs strategy) into practice and managing the EU's budget and programs.

[254] 1976 O.J. (C 301) 19.

[255] Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises, Aug. 20, 1990, 1990 O.J. (L 225) 10, Art. 6(1) [hereinafter EU Transfer Pricing Arbitration Convention].

[256] The EU Transfer Pricing Arbitration Convention was initially in force from January 1, 1995 through December 31, 1999 for a period of five years. Shortly before the expiration of the EU Transfer Pricing Arbitration Convention, the EU Council adopted a Protocol to the EU Transfer Pricing Arbitration Convention which provided for an automatic extension of the Convention by periods of five years, unless a Contracting State opposed. This Protocol was ratified by all 15 Member States in 2004 and the Arbitration Convention re-entered into force, with retroactive effect from 1 January 2000, on 1 November 2004.

procedural rules to follow, which promotes effective implementation of the EU Transfer Pricing Arbitration Convention. The EU Transfer Pricing Arbitration Convention provides a three phase process; MAP in the first phase, arbitration in the second phase, and elimination of double taxation in the third phase.

B. First Phase of the EU Transfer Pricing Arbitration Convention

The EU Transfer Pricing Arbitration Convention is composed of three chapters: Chapter 1 on the scope of the Convention, Chapter 2 on the General Provisions, and Chapter 3 on the Final Provisions. Chapter 2 governs the procedural aspects of the Convention which includes both the MAP and the arbitration procedures.

1. Submission of the Request

A request has to be filed by the taxpayer with its tax authorities within three years after the first notification of the action which results or is likely to result in double taxation.[257] The tax authority considers "the date of the first tax assessment notice or equivalent reflecting a transfer pricing adjustment which results or is likely to result in double taxation within the meaning of Article 1" as the starting point of the three-year period, since the application of the existing Arbitration Convention should be limited to those cases where there is a transfer pricing "adjustment".[258]

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[257] EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 6(1).

[258] Revised Code of Conduct for the effective implementation of the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, Dec. 30, 2009, 2009 O.J. (C 322) 1, at 1-10 [hereinafter EU Revised Code of Conduct].

A case will be regarded as having been submitted when the taxpayer provides the following:[259]

i. identification (such as name, address, tax identification number) of the company of the Contracting State that presents its request and of the other parties to the relevant transactions;
ii. details of the relevant facts and circumstances of the case (including details of the relations between the company and the other parties to the relevant transactions);
iii. identification of the tax periods concerned;
iv. copies of the tax assessment notices, tax audit report or equivalent leading to the alleged double taxation;
v. details of any appeals and litigation procedures initiated by the company or the other parties to the relevant transactions and any court decisions concerning the case;
vi. an explanation by the company of why it thinks that the principles set out in Article 4 of the EU Transfer Pricing Arbitration Convention have not been observed; [260]
vii. an undertaking that the company shall respond as completely and quickly as possible to all reasonable and appropriate requests made by a competent authority and have documentation at the disposal of the competent authorities; and
viii. any specific additional information requested by the competent authority within two months upon receipt of the taxpayer's request.

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[259] *Id.*, Art. 5(a).
[260] An example of the principles set out in Art. 4 of the EU Transfer Pricing Arbitration Convention, *supra* note 255, is the arm's length principle.

The competent authority will acknowledge the receipt of a taxpayer's request to initiate a MAP within one month from the receipt of the request, and, at the same time, inform the competent authorities of the other states.[261] The competent authority will ask the taxpayer, within two months from receipt of the request, to provide additional information if the information submitted is insufficient.[262] These seem to be practical obligations as they will work to prevent unnecessary delays by the competent authority in the procedure. Also, this feature of time limit distinguishes itself from the MAP provision of the OECD Model Tax Convention under which time delays are frequent due to the absence of mandatory time obligation, as the specific implementation of the MAP depends much on domestic laws of each State. In Korea, for example, there are no specific time limits imposed on the competent authority in terms of when to inform taxpayers and the competent authority of the other Contracting State.[263]

2. Rules for MAP

a. Initiation of MAP

As soon as the competent authority considers a case to be well-founded, it has to initiate the mutual agreement procedure by informing the competent authority of the other State of its decision with a copy of the information

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[261] EU Revised Code of Conduct, *supra* note 258, Art. 6.3(d).
[262] *Id.*, Art. 6.3(e).
[263] ITCA, *supra* note 96, Art. 22-23.

submitted by the taxpayer attached.[264] At the same time, it will inform the taxpayer that it will endeavor to resolve the case by mutual agreement with the competent authority of any other member State concerned.[265] Then, the competent authority informs the taxpayer that it has initiated the mutual agreement procedure.[266] The competent authority initiating the mutual agreement procedure also informs the competent authority of the other State and the person making the request whether the case was presented within the time limits.[267] The company requesting the mutual agreement procedure is kept informed by the competent authority to which it made the request of all significant developments that affect it during the course of the procedure.[268]

b. Two Year Time Period

If the competent authorities fail to reach an agreement that eliminates the double taxation within two years from the date on which the case was first submitted to one of the competent authorities, they shall set up an advisory commission that will be charged with delivering its opinion on the elimination of the double taxation. This two year period is suspended if the concerned taxpayer also pursues domestic course of remedy, such as domestic administrative appeal or litigation, therefore, the two year period would start

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[264] If the competent authority does not believe that profits of the company are included in the profits of a company in another State, it will inform the company of its doubts and invite it to make further comments. If the taxpayer's request appears to be well-founded and it can itself arrive at a satisfactory solution, it will inform the company accordingly and make as quickly as possible such adjustments. EU Revised Code of Conduct, *supra* note 258, Arts. 6.3(f)(i)-(ii).

[265] EU Revised Code of Conduct, *supra* note 258, Art. 6.3(f)(iii).

[266] EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 6(2); EU Revised Code of Conduct, *supra* note 258, Art. 6.3(g).

[267] EU Revised Code of Conduct, *supra* note 258, Art. 6.3(g).

[268] Id., Art. 6.3(b).

from the date a final decision is rendered by a court or tribunal. However, this two year time limit can be waived by a mutual agreement by the competent authorities and the taxpayers concerned.[269]

c. Observations

First, there is no time limit during which the competent authority can decide whether to initiate a MAP. However, in practice, the two year period during which the two competent shall "endeavor" to resolve the case works as a time limit required since the two year period starts ticking retroactively from the time the taxpayer submits all required information, [270] and this is the reason why the timing of when the taxpayer provides all of the above information is important. The two-year period starts on the latter of (a) the date of the tax assessment notice, i.e., a final decision of the tax administration on the additional income, or equivalent; or (b) the date on which the competent authority receives the request and the minimum information.[271]

Second, note that although the competent authority is neither obligated to accept the request nor reach a mutual agreement within 2 years once a MAP is initiated, in practice, it was reported that hardly any cases were rejected.[272] Also, although the two year time limit imposes only the obligation to form an advisory commission (but not necessarily an obligation to reach an agreement),

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[269] Id., Art. 7.

[270] It may be that the clock for the two year period can start ticking from the time the competent authority notifies the competent authority of the other State or the time the competent authority of the other State is in receipt of such notification from the competent authority of the original state, which can take a few additional months.

[271] EU Revised Code of Conduct, *supra* note 258, Art. 5(b).

[272] *Commission Staff Working Paper*, *supra* note 73, at 270.

such obligation, in practice, would work as an effective time limit for tax authorities to reach an agreement. Although waiving the two-year time limit under Paragraph 4 of Article 7 would diminish the force of the time limit, the fact that consent is required from the taxpayers is an improvement compared to the regular MAP process under bilateral tax treaties.

Third, the EU Revised Code of Conduct imposes extensive obligation on the competent authority to inform the taxpayer who triggered the process. The competent authority which received the case is obligated to (i) acknowledge the receipt of such case as presented by the taxpayer; (ii) inform the taxpayer if the information submitted is insufficient and to invite the taxpayer to supplement the information within two months, (iii) inform the taxpayer of its decision to initiate a MAP with the other competent authority; (vi) inform the taxpayer and the other competent authority that the case was submitted within the statute of limitation; (v) inform the taxpayer that the competent authority will try its best to resolve the case by mutual agreement with the other competent authority; and (vi) inform the taxpayer of all significant developments during the course of the procedure. As such obligation to inform would be effective in protecting taxpayers' rights and promoting their participation during the MAP, it may be worthwhile to consider adopting such similar obligations in the OECD Model Tax Convention as well.

Fourth, the Code of Conduct provides taxpayers with the opportunity to participate at a reasonable cost. The EU Transfer Pricing Arbitration Convention invites taxpayer to make a presentation to the competent authority where appropriate. Given that the taxpayers would have already gone through a tax audit prior to the MAP and already have relevant documents prepared, this

presentation opportunity would only involve a minimal cost of transmitting the documents to tax authority.[273]

Lastly, the Code of Conduct, by providing the guidance on specific procedural rules for implementing the EU Transfer Pricing Arbitration Convention, allows uniformity and consistency among the countries. Furthermore, the Code of Conduct, by requiring tax authorities to follow certain timelines and to inform the taxpayers, promotes practical functioning as well as transparency, the lack of which is one of the weaknesses of the current MAP. In other words, the current MAP can be improved by adopting timelines and obligations to inform similar to those under the Code of Conduct.

3. Exchange of Position Papers and Meetings

The competent authority of the country which makes the tax assessment sends a position paper to the competent authorities of the other states involved in the case, describing the case made by the person making the request, its view of the merits of the case, e.g. why it believes that double taxation has occurred or is likely to occur and how the case might be resolved with to eliminate double taxation, together with a full explanation of the proposal. Such position paper is to be sent within four months from (i) the date of the tax assessment notice, or (ii) the date on which the competent receives the request and all required information submitted by the taxpayer, whichever comes later. Since a taxpayer would generally bring his case to the competent authority after the tax assessment, the time limit imposed on the competent authority to send the

[273] Aleexander Voegele & Florence Forster, *The Arbitration of Transfer Prices in Europe,* 8 PRACTICAL EUROPEAN TAX STRATEGIES, no. 1, Jan., 2006, at 3.

position papers would generally be four months from the time the taxpayer submits all information to the competent authority. The position paper is accompanied by a basic documentation supporting the competent authority's position and a list of all other documents used for the adjustment.[274] The other competent authority will respond no later than six months after receipt of the position paper. The EU Revised Code of Conduct specifically prescribes the form in which the response is to be made.[275] The States organize meetings regularly, and at least once a year, face to face meetings are held between their competent authorities to discuss pending mutual agreement procedures (provided that the number of cases justifies such regular meetings). In order to minimize costs and delays caused by translation, the mutual agreement procedure, in particular the exchange of position papers, are mostly conducted in English as the common working language.[276]

Again, these time limits seem to work toward preventing unnecessary delays caused by the competent authorities.

C. Second Phase of the EU Transfer Pricing Arbitration Convention: Arbitration

1. Formation of the Advisory Commission

a. Composition of the Advisory Commission

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[274] EU Revised Code of Conduct, *supra* note 258, Art. 6.4(a)-(c).
[275] Id., Art. 6.4(e).
[276] Voegele and Forster, *supra* note 273, at 3.

If the States do not find a compromise under these mutual agreement procedures during the two-year period, the competent authorities have to establish an advisory commission, which would deliver an opinion on the elimination of double taxation in the case.[277] Such advisory commission has to be established no later than six months following the end of the two year period. Normally, the State that issued the first tax assessment notice takes the initiative for the establishment of this advisory commission and arranges for its meetings, in agreement with the other State.[278] Where one competent authority does not do this, another competent authority involved is entitled to take the initiative.[279] The advisory commission is to consist of:

- two representatives from each competent authority concerned;[280]
- an even number of independent persons of standing to be appointed by mutual agreement or by the drawing of lots by the competent authorities concerned;[281]
- chairperson to be appointed by the representatives and independent persons;
- secretariat who will assist the advisory commission.

Therefore, the advisory commission would generally consist of six persons, one chairperson, two representatives (one from each competent authority),[282] two independent persons, and a secretariat. When forming an opinion, only five

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[277] EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 7(1).
[278] Voegele and Forster, *supra* note 273, at 4.
[279] EU Revised Code of Conduct, *supra* note 258, Art. 7.2(b).
[280] But, the competent authorities can agree to one from each. *See* EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 9(1).
[281] Each competent authority nominates five independent persons.
[282] The number of representatives will vary depending on how many countries are involved in the case.

members excluding the secretariat will vote as the function of the secretariat is purely administrative. The costs of the advisory commission procedure will be shared equally by the States concerned.

b. Qualification of Independent Persons

The EU Transfer Pricing Arbitration Convention ensures the independence of the persons by prescribing that the competent authority has a right to object to the appointment of an independent person (i) where that person belongs to or is working on behalf of one of the tax administrations concerned; (ii) where that person has, or has had, a large holding in or is or has been an employee of or adviser to one or each of the associated enterprises; or (iii) where that person does not offer a sufficient guarantee of objectivity for the settlement of the case or cases to be decided.[283] Out of the list of independent persons nominated by each competent authority, the two competent authorities (or three in case more than two countries are involved) appoint, by mutual agreement, two independent persons and an alternate person for each independent person appointed in case the appointed independent person becomes unable to serve on the advisory commission.

Another qualification is that the independent person must be a national and resident of the EU, though not necessarily a resident or national of one of the States concerned.[284] For the chair person, a higher standard is required; he or

[283] EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 9(3).
[284] *Id.*, Art. 9(4).

she must possess the qualifications required for appointment to the highest judicial offices in his country or a jurisconsult of recognized competence.[285]

The EU Revised Code of Conduct provides more guidance by requiring the competent authority, when nominating independent persons, to describe the nominee's legal and tax experiences, with particular emphasis on transfer pricing. It also requires description as to whether the person qualifies as a chair person.[286] Also, the Code of Conduct requires such nomination to be made without delay, but it does not specify the time period during which the States must provide the names of eligible independent persons. The list of nominated independent persons is published on the EU Council's website.

2. The Opinion of the Advisory Commission

The States provide the advisory commission, before its first meeting, with all relevant documentation and information, including all documents, reports, correspondence and conclusions used during the mutual agreement procedure. A case is considered to be referred to the advisory commission on the date the Chairman receives all relevant documentation and information by its members.[287] The opinion of the advisory commission is to be delivered no later than six months from the date on which the matter was referred to it, [288] i.e. one year from the expiration of the two year period for the MAP expired. The opinion is to be adopted by a simple majority of the members of the advisory

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[285] *Id.*, Art. 9(5). Jurisconsult of recognized competence seems to mean a person who is qualified to become a judge or a person who has a legal training.
[286] EU Revised Code of Conduct, *supra* note 258, Art. 7.1.
[287] *Id.*, Art. 7.3(a).
[288] EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 11 (1).

commission,[289] and is expected to contain, among others, a description of the facts and circumstances of the dispute, a clear statement of the claim, a short summary of the proceedings, the arguments and methods on which the decision in the opinion is based and the opinion.[290]

3. Rules Regarding Confidentiality

Confidentiality of the case is protected by requiring the members of the advisory commission to keep secret all matters which they learn of as a result of the proceedings. If such confidentiality obligation is breached, the Contracting States are required to adopt appropriate provisions to penalize such breach of secrecy obligations, and inform the EU Commission of the measures taken; the Commission, in turn, informs the other Contracting States.[291]

The competent authorities of the States can consent to have the full decision and the opinion published; they can also agree to publish the decision and the opinion after redacting the names and other details that might disclose the identity of the companies involved. In either case, the companies' consent is required, and, prior to any publication, the companies involved must communicate in writing that they do not have objections to such publication of the decision and the opinion.[292]

4. Interaction with domestic course of remedy

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[289] *Id.*, Art. 11(2).
[290] EU Revised Code of Conduct, *supra* note 258, Art. 7.4 (prescribing the details in terms of what is to be included in the opinion).
[291] EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 9(6).
[292] *Id.*, Art. 12(3); EU Revised Code of Conduct, *supra* note 258, Art. 7.4(h)(ii).

Under the Code of Conduct, if taxpayers submit their cases to a court or a tribunal, then the two-year-period described above is stayed until the rendition of judgment by the final court of appeal.[293] This seems to mean that taxpayers are allowed to resort to domestic remedies while a MAP is in process, but in such case, taxpayers are required to complete or withdraw from the domestic remedial procedures before arbitration is initiated. Article 13 states that "the fact that the decisions taken by the Contracting States concerning the taxation of profits resulting from a transaction between associated enterprises have become final shall not prevent recourse to the procedures set out in Articles 6 and 7." Given that Article 6 is about MAP and Article 7 about an arbitration tribunal (advisory commission), the Code of Conduct seems to allow taxpayers to pursue both the domestic legal remedies and arbitration simultaneously, thus permitting "parallel proceedings," so long as domestic remedies are exhausted before arbitration is initiated. Regarding the issue of parallel proceedings, Dr. Jean-Philippe Chetcuti explains that the domestic and international procedures are not mutually exclusive and do not compete with each other as the mutual agreement (therefore, the arbitration decision) is binding only on the Contracting States but not on the national courts.[294] He further refers to a possibility of an enterprise being able to make a tactical decision of whether the enterprise should pursue a domestic remedy, an international procedure, i.e., arbitration, or combination of both.

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[293] EU Transfer Pricing Arbitration Convention, *supra* note 255, *supra*, 7(1).

[294] Jean Philippe Chetcuti, *EU Tax Arbitration Convention*, INTER-LAWYER, http://www.inter-lawyer.com/lex-e-scripta/articles/tax-arbitration.htm (last visited June 11, 2013).

There are two issues, however, with such "parallel proceeding." First, it is not clear which decision would be binding if the taxpayer ends up with both domestic remedies and a decision from a MAP and/or arbitration. Second, it is unclear whether, after arbitration has been concluded, the taxpayer can still invoke the domestic remedies if such domestic remedies have not been exhausted. The EU Transfer Pricing Arbitration Convention is silent on either of these issues.

A possible reason for the EU Transfer Pricing Arbitration Convention's silence on the aforementioned issues may be that there is no need for clarification. The goal of the Convention is to eliminate double taxation among affiliated companies located in different jurisdictions within the EU. Given that all issues brought under the Convention would lie within the realm of double taxation, so long as the taxpayer obtains a resolution, regardless of the course of remedy taken, double taxation would be eliminated and the taxpayer would have no further need to pursue a second course of remedy, i.e., the taxpayer would have no further issue to resolve.

With respect to the second issue, the reason why the EU Transfer Pricing Arbitration Convention is silent may be the existence of the so called "serious penalty" provisions. Under the EU Transfer Pricing Arbitration Convention, Contracting States are allowed to initiate judicial proceedings for administrative fines even if the taxpayer submitted the case to an arbitration advisory commission.[295] Furthermore, competent authorities are not obliged to initiate a MAP or arbitration, or stop the MAP or arbitration if the legal or administrative

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[295] EU Transfer Pricing Arbitration Convention, *supra* note 255, *supra*, 7(2).

actions resulted in a final ruling imposing serious penalty,[296] when there are legal or administrative actions pending which may result in the affected taxpayers being subject to a serious penalty.[297] Each nation defines "serious penalty" differently each EU member country declared the definition of 'serious penalty' and such declarations are annexed at the end of the EU Transfer Pricing Arbitration Convention as Unilateral Declarations. Even though each nation's definition is different, there is a consensus that serious penalty refers to a penalty to be imposed for willful non-compliance, fraudulent practices, negligent claims or returns for tax purposes, intentional tax evasion, and etc.[298] These "serious penalty" clauses can effectively prevent or deter taxpayers from seeking an alternative course of remedy under the domestic law[299] or vice versa because seeking alternative remedy may jeopardize them into being subject to a serious penalty provision if seeking alternative remedy can be seen as abuse of legal system.[300]

D. Third Phase of the EU Transfer Pricing Arbitration Convention: Elimination of Double Taxation

The competent authorities are required to accept decision of the advisory commission within six months after the decision is delivered. Such decision may deviate from the opinion of the advisory commission, but because it has to

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[296] *Id.*, Art. 8(1).
[297] *Id.*, Art. 8(2).
[298] *Id,* Unilateral Declarations.
[299] Chetcuti, *supra* note 294.
[300] There has been no reported case of such legal or administrative actions started by the States. *Commission Staff Working Paper*, *supra* note 73, at 270. However, the Working Paper having been published in 2001, it has been 11 years already, but no information could be found on whether this "serious penalty" provision of Article 8 of the EU Transfer Pricing Arbitration Convention was ever used.

avoid double taxation,[301] it practically becomes a compromise among the States involved. The double taxation of profits is considered to be eliminated if (i) the profits are included in the computation of taxable profits in one State only; or (ii) the tax chargeable on those profits in one State is reduced by an amount equal to the tax chargeable on them in the other State.[302]

E. Lessons to be Learned from EU Transfer Pricing Arbitration Convention

1. Strengths

a. Improvements to the MAP

The entire process under the EU Transfer Pricing Arbitration Convention, including the MAP and arbitration, is to take about three years from initiation of the MAP—i.e. when the affected taxpayer submits all the required information—until completion. This shows that the EU Transfer Pricing Arbitration Convention Provides a more efficient process compared to the MAPs under bilateral tax treaties by ensuring that the taxpayer obtains relief from double taxation within a period which, under a bilateral tax treaty, the competent tax authorities may very well be still "endeavoring" to resolve the issue "amicably."

b. Improved Legal Position of Taxpayers

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[301] EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 12(1)-(2).
[302] *Id.*, Art. 14.

Obligation to Inform Taxpayers

The competent authorities have an extensive obligation to inform taxpayers of the status of the case, including whether the taxpayer submitted the request in a timely manner, whether the competent authority to which the case is presented decided to initiate a MAP, and whether the competent authority actually started the MAP as well as the discussions that take place during the MAP. In the MAPs taking place under the bi-lateral tax treaties, there is no such obligation either in the treaty itself or in the domestic laws that implement the MAP.

Participation by Taxpayers

One of the disadvantages of the MAP under a tax treaty is that taxpayers are excluded from the process as the entire process is under the sole control of the competent authority. However, the EU Transfer Pricing Arbitration Convention specifically allows taxpayers to appear or to be represented before the advisory commission as well as to supply any significant information for the advisory commission to use in reaching a decision.[303] The advisory commission has reciprocal rights to ask the concerned taxpayers to appear or be represented to the commission.

Confidential But Transparent

As discussed above, the EU Transfer Pricing Arbitration Convention requires that the members of the advisory commission keep secret all matters that they

[303] EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 10(2).

learn of as a result of the proceedings. It further provides that a breach of this confidentiality obligation can result in a punitive action.[304] This is one of the strongest features of any given arbitral procedure in that it values the confidentiality of the parties involved.[305] This feature is to be compared with the approach taken by the OECD in Chapter 4.[306]

Independent and Impartial Jurisdiction

With respect to the composition of the advisory commission and the nomination of its members, the EU Transfer Pricing Arbitration Convention and its Code of Conducts ensure independence and impartiality by requiring the members to be competent and independent and the chair person to have the qualifications needed for the highest judicial offices. Furthermore, there is a right of eviction of an independent member if (i) such member is associated with one of the competent authorities involved or with the taxpayers; or (ii) if the person does not offer a sufficient guarantee of objectivity. This possibility of being evicted works to ensure a higher standard of independence and impartiality.[307]

c. Guarantee of Elimination of Double Taxation

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[304] *See in general supra*, Ch. 2, Part II for discussion on the confidential nature of the current MAP.
[305] Chetcuti, *supra* note 294, para. 1.2.9.
[306] See *infra* Ch.4, Part III.B.C.
[307] See *infra* Ch.4, Part III.B.1 for discussion of qualification of arbitrators under the OECD Model Convention.

The EU Transfer Pricing Arbitration Convention procedures are effective by guaranteeing the elimination of double taxation arising out of cross-border transfer pricing within a total time period of three years.[308,309]

d. Multilateral Agreement

The multilateral nature of the EU Transfer Pricing Arbitration Convention adds another benefit to disputes involving more than two countries, a common situation in transfer pricing cases, since the dispute can be resolved at once without applying simultaneously all of the bi-lateral treaty involved.[310]

2. Weaknesses

The EU Transfer Pricing Arbitration Convention is only applicable to double taxation cases arising out of transfer pricing. In other words, if the dispute involves cases of double taxation caused by a conflicting interpretation of treaty terms, the EU Transfer Pricing Arbitration Convention would not be applicable.[311] Note, however, that while such limited applicability is a weakness of the EU Transfer Pricing Arbitration Convention, even in such situation, the taxpayer would not be entirely deprived of remedies because the MAP under a bilateral tax treaty, though may be less efficient due to the slower MAP progress, can be invoked as a second option.

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[308] Voegele and Forster, *supra* note 273, at 4.
[309] See *infra* Ch. 4, Part II, G for discussion of the OECD Model Tax Convention's guarantee on elimination of double taxation.
[310] *Id.*, at 4.
[311] *Id*.

Another weakness of the EU Transfer Pricing Arbitration Convention is that it is a convention, not a Directive. Since the EU Commission and the ECJ is neither entitled nor obliged to supervise the correct application of the EU Transfer Pricing Arbitration Convention,[312] each State would exercise its own discretion to regulate and interpret it--such practice would result in confusion and inefficiency by creating differing interpretations of the convention among member states. After all, adoption of the EU Transfer Pricing Arbitration Convention in the form of a convention[313] was a political result caused by the member states' resistance against surrendering their fiscal sovereignty.

3. Sub-Conclusion

EU Transfer Pricing Arbitration Convention has been in existence for almost two decades and has developed into one of the main methods of international tax dispute resolution in the area of transfer pricing. Though its application is confined to the EU member states, the arbitration provisions, especially those related to the advisory commission and its opinion, shed much light on what needs to be done in the area of mandatory arbitration clause in the 2008 OECD Model Tax Convention. Though some of the strengths of the EU Transfer Pricing Arbitration Convention are also reflected in the arbitration provision of the OECD Model Tax Convention, for those strengths that are not reflected in

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[312] Voegele and Forster, *supra* note 273, at 4.

[313] A directive is a legislative act of the European Union, which requires the member states to implement it as their domestic laws to achieve a particular result without dictating the means of achieving that result. The EU Commission and the ECJ have jurisdiction over regulating and reviewing whether the domestic laws are consistent with the directive. On the other hand, a convention is an agreement, which also becomes a part of the domestic laws when ratified. However, the State has the authority to regulate and interpret the convention within its own territory.

same, serious consideration should be given as to whether it is possible for those strengths to be adopted by the OECD as well, which are discussed in detail below in Part V.

IV. Example of Arbitration Cases in which Tax was the Subject Matter

According to Altman, Park and Chloe, there has been no tax treaty arbitration yet. It is true that there has been no tax treaty arbitration under bilateral income tax treaties, but there have been several arbitration cases, in which tax was the main subject matter, in other legal contexts.

For example, in as early as 1922, there was an arbitration award dealing with excess war taxes under a special convention between Spain and France. In the 1960s, three other cases dealing with succession taxes under the Italy – U.S. World War II Peace Treaty were published.[314] Taxes are also partially covered by investment treaties, and the Iceland v. Alusuiss case, introduced below, is an example of tax arbitration case originating from an investment treaty--the issues stemmed from an investment agreement between a private company and the Icelandic government. In the Greek taxpayer case, which is also summarized below, the Greek taxpayer had forced the Greek government to accept the jurisdiction of a Swiss arbitration tribunal. Korea has a tax arbitration case in progress currently for a claim filed by Lone Star Funds[315] for damages of up to 2.4 trillion won alleging that the Korean Government has violated its various obligations under the Korea-Belgium bi-lateral Investment Treaty. Lone Star

[314] Altman, *supra* note 4, at 346 nn.1205, 1206.
[315] See *infra* note 253

Funds had invested in Korea Exchange Bank and other corporate stocks through a Belgium-based arm, but the Korean tax authority denied the application of the Korea - Belgium tax treaty arguably due to lack of substance in the Belgian company owned by the Lone Star Funds. Lone Star Funds is claiming that the denial of the Korea - Belgium tax treaty, therefore, the imposition of capital gains tax is an "indirect expropriation" in violation of the Korea-Belgium Investment Treaty.

The above cases primarily involve an issue of expropriation—whether the acts of the State with respect to tax amounted to expropriation under the relevant investment treaties. These cases were brought by private investors against the government of a country, in which they made an investment, claiming that the government breached the relevant bilateral investment treaty. Tax treaty arbitrations are necessarily different from these investment arbitrations because tax treaty arbitrations will be between the two governments without involving private parties. Nonetheless, the above cases are introduced in this section for reference purposes in case tax arbitration cases arise under tax treaties in the future.

1. Iceland and Alusuiss Arbitration Case[316]

In the 1970s, the government of Iceland and a Swiss firm Alusuiss entered into an agreement (the Master Agreement) relating to the construction and operation of an aluminum reduction plant and appurtenant facilities owned by Icelandic Aluminum Company ('ISAL'), an Icelandic Company in which Alusuiss held

[316] Maktouf, *supra* note 61, at 42.

substantial shares. Scheduled documents pertaining to the Master Agreement included certain Assistance Agreement between Alusuiss and ISAL. Pursuant to the Master Agreement, ISAL was to pay Iceland a yearly consolidated tax on its net profits. The depreciation rules, allocation methods and other transfer pricing issues were addressed in the Master Agreement. By 1980, a dispute arose over the consolidated tax payable to the Icelandic government. In Particular, the dispute concerned a certain allocation method relating to the structure of a reserve fund, the interpretation of provisions in the Assistance Agreement, and methods for defining the price of raw materials for tax purposes. All these items had a crucial impact on the computation of ISAL's net profits, and, in turn, on the determination of the consolidated tax amount due. After an attempt to settle the dispute through negotiations failed, the parties, pursuant to the Master Agreement, referred the dispute to ICSID.[317] On 23 September, 1983, shortly after initiating the arbitration procedure before ICSID, the parties, by Interim Agreement, decided instead to settle the dispute through an *ad hoc* arbitration. The parties justified their decision by the fact that they both preferred to resolve the dispute in a more amicable and speedy manner.

The Panel was composed of three tax experts. One member was appointed by each party and the Chairman, not a national of either Switzerland or Iceland, was appointed by agreement between the two experts appointed by the parties. The panel was supplemented by a separate panel of Icelandic tax experts. The separate panel was to address the following issues:

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[317] Swiss Aluminum Ltd. and Icelandic Aluminum Co. Ltd. v. Iceland. ICSID Case No. ARB/83/1 (June 16, 1983). The settlement was agreed by the parties and proceeding discontinued at their request. Order of the Secretary-General taking note of the discontinuance was issued on March 6, 1985.

- ISAL's currency exchange loss for purpose of the consolidated tax;
- Depreciation of anti-pollution equipment used by ISAL;
- Allocation into a special reserve fund pursuant to the Master Agreement; and
- The right for the Icelandic government to assess penalties under the Master Agreement.

Only four weeks were allowed for constitution of the panels. The opinions of the panels had to be submitted no later than six months after their constitution. Then, within two weeks after the date on which both opinions of the two panels have been submitted to the parties, a third panel consisting of the State Auditor of Iceland, the Statutory Auditors of ISAL and an independent public accountant as chairman of such panel was formed according to the Interim Agreement. The third panel was to recalculate the consolidated tax liabilities of ISAL for the tax years at issue. The third panel had three months to render the results of the computation. Such results in the terms of the Interim agreement were final and binding upon the Parties.[318] Each party agreed to bear its own costs relating to the three panels as well as the costs of members appointed by that party. Both parties were to bear the Chairman's expenses equally.

The arbitration proceedings were kept secret. Reportedly, the hearings and exchange of briefs went smoothly and the arbitration award has been enforced successfully.

[318] It should be noted that the Interim Agreement did not deal exclusively with arbitration; the parties instead used the opportunity to modify certain substantive issues in the Master Agreement.

2. Greek tax arbitration cases[319]

This case involves a Greek taxpayer that entered into an agreement with the Greek tax authority as to the tax structure that was planned for its business in Greece. It is not known whether the Greek taxpayer was a resident of Greece. The agreement with the Greek tax authorities included an arbitration clause calling for a mandatory reference of any dispute to arbitration.

Subsequent to a tax dispute, the Greek taxpayer relied on the arbitration clause to compel his government to accept a Swiss arbitration tribunal. The Swiss arbitration tribunal was composed of a judge from the Swiss Supreme Court as an umpire, a Swiss lawyer on behalf of the Greek taxpayer, and a representative of the Greek government. Exchange of briefs, hearing and pleading reportedly were conducted without any difficulty and awards were made quickly in both cases, and subsequently enforced by both parties.

3. Algerian Tax Arbitration[320]

Approximately twelve years ago, a dispute arose between the Government of Algeria and a US oil company incorporated in Algeria. At issue was the tax treatment of certain cash bonuses paid by the company to the Algerian Government pursuant to a prior agreement between them. Specifically, the company treated the cash bonuses as deductible expenses, but the Algerian government objected to such treatment. Once the dispute arose, the parties followed the arbitration clause contained in their agreement to refer their tax

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[319] Maktouf, *supra* note 61, at 46.
[320] *Id.*

dispute to an ICC sponsored arbitral tribunal. Reportedly, the parties implemented the arbitral award which was kept confidential.

4. What the Cases Tell Us

Though we have access to the arbitral award details in none of the foregoing cases, these cases shed a light on how we may approach in promoting the use of arbitration in international tax disputes. Important to note is that the governments in these cases referred their disputes to binding international arbitration; this impliedly demonstrates that (1) the subject matter of tax does not necessarily prevent use of arbitration in tax disputes; (2) in a tax case, arbitration panel may be organized ad hoc, but an institutional body, such as ICC or ICSID, may also be used for administration;, and (3) arbitration may achieve more popularity with respect to tax disputes by adopting the design and application scheme shown in the arbitration agreements of the above-cited cases. To this end, suggestions are made in this paper as to how the tax arbitration scheme under the OECD model may be improved.

CHAPTER 4. CRITIQUE OF THE OECD MODEL ARBITRATION CLAUSE AND PROPOSAL FOR IMPROVEMENTS

I. Introduction

This chapter attempts to analyze the arbitration provisions newly introduced in the OECD Model Tax Convention in 2008.[321] Article 25(5) of the OECD Model Tax Convention provides:

> *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,*
>
> *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*

[321] The OECD published a revised OECD Model Tax Convention in 2010, but the provision on arbitration did not change from the 2008 version.

> *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.*[322]

As part of the Commentary to Article 25, the OECD introduces a sample mutual agreement on arbitration agreement (the "OECD Sample Agreement"), which contains the following 20 provisions for the competent authorities to consider in making an arbitration agreement:[323]

1. Request for submission of case to arbitration
2. Time for submission of the case to arbitration
3. Terms of reference
4. Failure to communicate the terms of reference
5. Selection of arbitrators
6. Streamlined arbitration process
7. Eligibility and appointment of arbitrators
8. Communication of information and confidentiality
9. Failure to provide information in a timely manner
10. Procedural and evidentiary rules: III.C.
11. Participation of the person who requested the arbitration

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[322] There is a footnote to the final sentence that provides assurance that countries need not include this paragraph in a treaty if they face legal or policy barriers to what it requires and that, alternatively, they may modify it by removing the prohibition on arbitration where the issues have already been considered by domestic courts.

[323] 2010 OECD Model Tax Convention, *supra* note 119, Commentary to Art. 25, Annex, Sample Mutual Agreement on Arbitration, para. 1 [hereinafter OECD Sample Agreement].

12. Logistical arrangements
13. Costs
14. Applicable legal principles
15. Arbitration decision
16. Time allowed for communicating the arbitration decision
17. Failure to communicate the decision within the required period
18. Final decision
19. Implementing the arbitration decision
20. Where no arbitration decision will be provided

As shown in the OECD Commentary, designing an effective tax arbitration system entails many administrative considerations, such as execution of arbitration agreement, formation of arbitral tribunal, compensation, cost, venue, arbitration proceeding, and the form of arbitral decision. Also, the system must be flexible enough to accommodate different types of disputes in a time- and cost-efficient manner. To this end, the following sections will discuss a list of procedural elements of arbitration, the taxpayer's status, and the applicable substantive norms, all of which should be considered in building an effective tax arbitration system.

Each paragraph of the OECD Sample Agreement is discussed in this Chapter within the context of international arbitration. Part II discusses preliminary issues including discussion on Paragraphs 1 and 2, as well as such issues as mandatory nature of arbitration and the relationship with domestic remedies. Specifically, Part II.B discusses Paragraph 11 and the binding effect of arbitral decisions because the extent of taxpayers' participation is related to the taxpayer's status during and after arbitration, which, in turn, is intertwined with

the binding effect of the arbitral decisions, as will be also discussed. Part III is focused on procedural matters, which are covered under Paragraphs 3-10, 12-14, 16, 17 and 20 of the OECD Sample Agreement. Paragraphs 15, 18 and 19 which are related to recognition and enforcement of arbitral decision are discussed separately in Chapter 5. These issues can be analyzed only in the context of the legal system of a particular country within which recognition and enforcement of the arbitral decision is sought. Analysis in this dissertation is limited to the Korean domestic legal system; Korean law will be analyzed to the extent of recognizing and enforcing foreign decisions and implementation of mutual agreements. The primary frame of reference for evaluating the OECD's proposal and suggesting improvements in these chapters is the originally intended purposes of tax arbitration—i.e. to resolve cross-border tax issues that the competent authorities failed to resolve for at least two years.

II. Analysis of Major Substantive Issues

A. Mandatory Nature of Arbitration

While the OECD purports to provide for mandatory arbitration in its Model Tax Convention, this paper will analyze whether or not arbitration should indeed be made mandatory from two different perspectives: (1) the initiation of arbitration (i.e. certain event causes the relevant parties to go into arbitration); and (2) the acceptance of arbitration decision, i.e., the arbitration decision is final and binding on relevant parties). This section focuses on the discussion of mandatory arbitration initiation process. Discussion on the binding nature of arbitration decision is separately set out in Part B below.

1. OECD's Approach

According to the OECD Model Tax Convention, an arbitration can be initiated only at the request of a person who initiated MAP as Paragraph 5 of Article 25 states as follows:

> *Article 25.* 【*MUTUAL AGREEMENT PROCEDURE*】
>
> *5. Where,*
>
> *a) . . . 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,*
>
> *any unresolved issues arising from the case* ***shall*** *be submitted to arbitration* ***if the person so requests . . . .*** *[emphasis added].*

This effectively means that arbitration under the OECD Model Tax Convention is mandatory only for the competent authorities, but not for the taxpayers. The OECD Commentary to Article 25 indeed makes it clear that the arbitration is optional for taxpayers by providing that the taxpayer "may prefer to wait beyond the two year period or not to pursue the case."[324]

In practice, however, the mandatory nature of the arbitration initiation process from the government's perspective is likely to be nullified because it is doubtful that the taxpayer will make an independent decision to pursue arbitration.

[324] 2010 OECD Model Tax Convention, *supra* note 116, Commentary to Art. 25, para. 70.

Rather, taxpayers are likely to consult with the competent authority (to which it submitted its initial request for MAP) as to whether it should request arbitration. The foregoing phenomena is attributable to the fact that taxpayers' heavily dependent attitude during the MAP continues to the post-MAP stage. As to why taxpayers are so dependent on the competent authority during the MAP, because the MAP is essentially a negotiation process between two governments, in which taxpayers' participation is excluded, during the MAP, the taxpayers tend to rely on the competent authority as their only source of information regarding the progress of the MAP. Furthermore, because taxpayers are reluctant to cause tension with the authorities (especially out of fear that their interest would not be supported by the competent authority during the potential arbitration), it is unlikely that the taxpayer will make an independent decision to initiate arbitration without first obtaining consent from the competent authority. Considering that the taxpayers have the key to initiating arbitration, their dependency on competent authority would result in effective nullification of the mandatory nature of the arbitration initiation process under the OECD Model Tax Convention.

2. Comparison with Other Arbitration Clauses

Austria – German Tax Treaty

The arbitration-related provision in the Austro-German Income Tax Convention is similar to that of the OECD Model Tax Convention in that it requires taxpayers to request arbitration in order for the competent authorities to submit the unresolved case to arbitration. The Austro-German Tax Convention appoints the European Court of Justice ("ECJ") as the arbitrator and allows the ECJ to

interpret treaty disputes between member countries.[325] Unofficial translation would read as follows:

> *If any difficulty or doubt arising as to the interpretation or application of this Convention cannot be resolved by the competent authorities in a mutual agreement procedure within a period of three years after the question was raised [in a mutual agreement procedure], then upon request of [the taxpayer], the Contracting States shall be obliged to submit the case to arbitration at the Court of Justice of the European Communities under Article 239 EC Treaty.*[326]

Thus, the Austro-German Tax convention requires that any tax dispute which cannot be settled by MAP in three years[327] must be referred to the ECJ for resolution.[328] This is identical to what the OECD arbitration provision dictates with one difference; the Austria-German Tax Treaty goes one step further specifically to require the competent authorities to submit the case to the ECJ. Such specific instruction is a good example of how the current OECD

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[325] It is possible that arbitration by the European Court of Justice is not arbitration due to the fact that judges of the European Court of Justice render a decision, therefore, some may argue that it is a court decision in lieu of an arbitration decision. Nonetheless, the relevant parties agree to an arbitration and the parties specifically chose European Court of Justice to act as an arbitrator, therefore, having the European Court of Justice as an arbitrator should not pose any legal obstacle.

[326] Arbitration under the Austro-German Tax Treaty is initiated by a taxpayer, which leaves a concern that what happens if a taxpayer does not initiate one, as discussed above.

[327] Austro-German treaty gives the tax administration a year longer than the two year period under the OECD Model Tax Convention or the EU Transfer Pricing Arbitration Convention.

[328] Züger, *supra* note 158, at 114.

mandatory arbitration provision can be modified to accommodate each State's needs and circumstances.

Arbitration Clause of the US-Germany Tax Treaty

It may be worthwhile to compare the OECD approach with the arbitration provision of the 2006 Protocol of the tax treaty between the U.S. and Germany (the "2006 Protocol").[329] The 2006 Protocol does not contain any requirement that the concerned person[330] has to make a request for an arbitration proceeding to commence. Rather, it requires unresolved cases be referred to arbitration,[331] which means that arbitration is simply imposed on the competent authorities and automatically commenced when cases are not resolved. At the same time, the 2006 Protocol gives the taxpayer an option to object to arbitration, and if the taxpayer wishes to suspend the arbitration, such taxpayer is required to withdraw from the entire MAP. In sum, arbitration under the 2006 Protocol is restrictive and compulsory. The advantage of such compulsory arbitration is

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[329] The U.S. and Germany signed the Protocol Amending the Convention Between the U.S. and Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes ("U.S.-Germany Income Tax Treaty") on June 21, 2006 [hereinafter 2006 Protocol]. The 2006 Protocol replaced the arbitration paragraph with the new mandatory arbitration paragraph in Article 25 of the Income Tax Treaty. On December 17, 2008, the two countries signed the Competent Authority Agreement ("2008 MOU"), which is a Memorandum of Understanding setting forth the guidance under which the U.S.-German arbitration procedure will operate.

[330] The term "concerned person" refers to a person who presented a case to a competent authority for consideration for a MAP per Paragraph 6(b) of Article 25 of the U.S. and Germany Income Tax Treaty as signed in 1989.

[331] 2006 Protocol, *supra* note 329, Art. 16, Para. 22. There is an argument that the arbitration is not quite mandatory because the competent authorities can agree not to allow a case to go to arbitration; *see in general*, David Tillinghast, *Issues in the Implementation of the Arbitration of Disputes Arising under Income Tax Treaties*, 56 BULL. FOR INT'L FISCAL DOCUMENTATION 90 (2002).

that it facilitates swift decision-making process in initiating arbitration, promoting efficiency in the dispute resolution process.

EU Transfer Pricing Arbitration Convention

The EU Transfer Pricing Arbitration Convention is similar to the U.S.-Germany Tax Treaty in that arbitration becomes mandatory upon the expiration of the two-year period.[332] Also, the EU Transfer Pricing Arbitration Convention provides more specific guidelines in that it imposes on the competent authority the obligation to start forming the advisory commission, which is equivalent to an arbitration board under the U.S.-Germany Tax Treaty. If the competent authority that issued the first tax assessment notice takes no action with respect to establishing the advisory commission, then another competent authority involved in the MAP is entitled to take the initiative.[333] There is no need to obtain consent from taxpayers in commencing arbitration. Further, taxpayers do not need to take an action to commence arbitration.

3. Sub-Conclusion

Unlike the OECD arbitration provision under which only the taxpayers are allowed to initiate arbitration by requesting it, neither the U.S.-Germany Tax Treaty nor the EU Transfer Pricing Arbitration Convention requires any action from the taxpayers with respect to initiating arbitration. Instead, both treaties impose on the competent authorities the obligation to refer unresolved cases to

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[332] EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 7(1).
[333] EU Revised Code of Conduct, *supra* note 258, Art. 7.2(b).

arbitration, which is to be commenced almost automatically after the expiration of the two year period.

Discussed above was competent authorities' reluctance toward arbitration because they do not want to surrender their sovereignty to a third party with respect to their tax case. Thus, rather than expecting that the competent authorities would submit a case to arbitration, a better approach would be to (i) require the competent authorities to refer unresolved cases to arbitration (which is the case in the U.S.-Germany Tax Treaty and the EU Transfer Pricing Arbitration Convention); and (ii) provide taxpayers an option to accept or reject such initiation of arbitration by having competent authorities obtain consent from taxpayers.

One may argue that requiring a taxpayer's consent on arbitration is equivalent to taxpayer's requesting arbitration in that the taxpayer is given the controlling power. However, there exists a clear distinction between actively seeking arbitration and passively consenting to one; the former requires more efforts and actions, sometimes against their own tax authority, while the latter merely involves nodding their heads to the competent authority's suggestion. Furthermore, requiring taxpayer's consent at the initiation of arbitration would minimize the possibility that such taxpayer does not accept the arbitration decision when so much resource has been already invested in closing the case. Thus, it is suggested that the current OECD provision be amended so that the concerned competent authorities" are obligated to initiate arbitration on the condition that the relevant taxpayer's consent is obtained—this condition would protect the taxpayer's right. To further promote efficiency and swift progress, the relevant provision may also provide to the effect that the taxpayer consent is

deemed granted if the taxpayer does not object within one month from the notification of initiation of arbitration by the competent authorities.

OECD MODEL TAX TREATY	SUGGESTED CHANGES
Article 25, Paragraph 5. *...any unresolved issues arising from the case shall be submitted to arbitration if the person so requests.*	…any unresolved issues arising from the case shall be submitted to arbitration by one of the competent authorities after obtaining the consent from the person who requested MAP under Paragraph 1 above. Such consent shall be deemed to have been granted if the person does not respond to the competent authority's request for consent to arbitration within 30 days from the date such request for consent is received by the taxpayer.
OECD SAMPLE AGREEMENT	SUGGESTED CHANGES
1. Request for submission of case to arbitration *A request that unresolved issues arising from a mutual agreement case be submitted to arbitration pursuant to paragraph 5 of Article 25 of the Convention (the "request for arbitration") shall be made in*	*Initiation of Arbitration* (a) A request for arbitration shall be considered to have been presented on the date the first competent authority notifies the other competent authority (the second competent authority).

writing and sent to one of the competent authorities. The request shall contain sufficient information to identify the case. The request shall also be accompanied by a written statement by each of the persons who either made the request or is directly affected by the case that no decision on the same issues has already 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.	The second competent authority shall confirm the receipt of the copy of the request for arbitration. (b) Unless otherwise agreed between the competent authorities, the competent authority that issued the tax assessment notice or a final decision of the tax administration (first competent authority) that became the subject matter of the MAP takes the initiative for the establishment of the arbitral tribunal and obtaining the consent from the taxpayer for arbitration.

B. Binding Effect of Arbitral Decision

1. Under the OECD Model Tax Convention

The binding effect of the arbitration decision is laid out in Paragraph 19 of the Sample Agreement as follows:

The OECD Sample Agreement does not explicitly discuss the person's ability to accept the decision. Instead, it provides that the arbitration decision will be implemented by reaching a mutual agreement. The implication of the foregoing

condition is that the taxpayer has a choice to either accept or reject the arbitration decision[334] because mutual agreement is subject to the acceptance by the taxpayer. In other words, the arbitration decision under the OECD Sample Agreement is not necessarily binding on the taxpayers as they are given the authority to reject the decision.

The OECD further states that the failure to implement the arbitration decision through the conclusion of a mutual agreement would result in taxation that is inconsistent with the applicable tax treaty.[335] This implies that the OECD has considered a situation where the competent authority does not accept the arbitral decision, leaving the taxpayers to resort to a domestic course of remedy or to another MAP.[336] Note, however, by requesting another MAP under the applicable tax treaty, the taxpayer would only go back to where it started prior to the unsuccessful arbitration. Also, given that the two competent authorities, prior to the unsuccessful arbitration, had already failed to reach an agreement under the MAP for two years, the likelihood of success would be low for the second MAP.

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[334] The OECD notes that, as a practical matter, experience shows that there are very few cases where the taxpayer rejects a mutual agreement to resort to domestic legal remedies. Also, in these rare cases, one would expect the domestic courts or administrative tribunals to take note of the fact that the taxpayer had been offered an administrative solution to the case that would have bound both States. 2010 OECD Model Tax Convention, *supra* note 116, Commentary to Art. 25, para. 79. However, because such rejection by taxpayer is rare, it does not mean that all arbitral decisions would be accepted by taxpayers.

[335] OECD Sample Agreement, *supra* note 323, Explanations, para. 42.

[336] The fact that the OECD considered such possibility suggests that the countries may have different laws as to how arbitral decisions (or the mutual agreement) are implemented. It is possible that, in certain countries, the competent authority is not required to implement the mutual agreement.

In summary, it seems that the arbitral decision is not really binding on any party because (i) the taxpayer is able to reject the arbitral decision; and (ii) the OECD contemplated a situation in which the competent authorities do not implement the arbitral decision. In either case, the taxpayer can pursue another MAP or a relief under domestic law. If another MAP is commenced, given that the competent authorities were unable to resolve the dispute for 2 years under a MAP prior to the unsuccessful arbitration, the likelihood of success would be marginal for the second MAP. Furthermore, if the second MAP is again unsuccessful, the case may again end up in arbitration again. Given the foregoing possibility, the only remaining option for the taxpayer would be to resort to a domestic course of remedy. This result seems to defeat the purpose of arbitration; that is to resolve the disputes which the competent authorities could not resolve for two year under a MAP.

2. U.S.-Germany Income Tax Treaty

The U.S. - Germany Income Tax Treaty states that the arbitration board's decision is binding on the competent authorities [337] and becomes part of the mutual agreement under the MAP.[338] Such arbitration decision in the form of mutual agreement is to be accepted by the presenter of the case, but if the presenter rejects the decision, the presenter is forbidden to initiate another proceeding. [339] Therefore, even though the arbitration decision is to be implemented through a mutual agreement once the arbitration proceeding has been completed, the taxpayer would be careful in deciding whether to accept or

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[337] 2006 Protocol, *supra* note 329, para. 22(j).
[338] *Id*., para. 22(k).
[339] *Id*.

reject it because the taxpayer would not be able to pursue another MAP or arbitration.

3. EU Transfer Pricing Arbitration Convention

The EU Transfer Pricing Arbitration Convention takes an approach that is in sharp contrast with that of the OECD and the U.S.-Germany Tax Treaty in that it makes the arbitration decision binding on all parties, i.e., both of the competent authorities and all other persons whose tax liability would be affected by the decision.

Such binding effect of the arbitral decision seems possible because (i) the EU Transfer Pricing Arbitration Convention requires arbitral decisions to eliminate double taxation, which is the fundamental reason for arbitration (i.e. if the double taxation, which was the issue, was resolved, there is no reason not to accept the decision); and (ii) the EU Transfer Pricing Arbitration Convention allows the concerned persons, including the taxpayers, to participate and represent themselves in the arbitration proceedings. When the taxpayers had opportunities to represent themselves at arbitration, they are likely to accept the outcome of the arbitration. This binding nature of the arbitration decision under the EU Transfer Pricing Arbitration Convention is desirable because it effectively serves the most fundamental purpose of arbitration—final resolution of disputes that could not be resolved in a MAP under an applicable tax treaty.

With respect to adopting similar obligations in the OECD Model Tax Convention, there is an inherent difficulty because the scope of issues for arbitration under the OECD Convention is not limited to double taxation issues.

However, it would still be beneficial to adopt similar obligation in the OECD Convention at least with respect to double taxation issues to the extent possible.

4. Status of Taxpayer

The current arbitration provision does not envision a taxpayer to be a party to arbitration. This may stem from the States' concern that arbitration usurps their sovereignty and that arbitration that is entirely run by the taxpayer is not acceptable.[340] However, that does not mean that taxpayers must be left out of the process entirely except for requesting the arbitration at the beginning. After all, it is the taxpayer whose interest lies at the core of the issue, and therefore would be the most motivated to have the dispute resolved—much more so than any of the two competent authorities.

Notwithstanding the foregoing, the current OECD arbitration provision does contemplate that taxpayers can present their position *to the extent they can do so during the MAP*. However, as it was discussed earlier, one of the weaknesses of the MAP is that taxpayers are virtually excluded from the MAP process.[341] Thus, to limit taxpayers' participation in the arbitration to the same extent they can participate in the MAP would mean that taxpayers cannot participate in the arbitration proceedings. Furthermore, the OECD requires consent of the arbitrators for the taxpayer to appear before the board. The procedure would be that (i) the concerned taxpayer first asks the competent authority whether the taxpayer can appear at the arbitration for oral presentation; (ii) the competent authority would ask the Chair of the arbitration board whether the taxpayer's

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[340] Burnett, *supra* note 159, at 182.
[341] *See supra* Chapter 2, Part II. C. 4.

request is permissible; and (iii) the Chair inquires with other arbitrators. Given that one of the arbitrators is appointed by the competent authority, the arbitrator is likely to ask the competent authority whether they can grant such permit. In reality, the taxpayer would not even ask the competent authority from the beginning if such request is against the will of the competent authority. The more likely scenario is that, if the competent authority determines that it would be helpful to have the concerned taxpayer appear at the arbitral proceedings, then such competent authority would ask the taxpayer to make a formal request. Given this reality of the MAP, the current arbitration provision is not quite effective in providing the taxpayer a right to participate in the arbitration proceeding.

Nonetheless, there is one feature in arbitration proceeding that is an improvement from the MAP proceeding in terms of taxpayer's status, which is the arbitral board's duty to inform the taxpayer when (i) the arbitral board receives all the information necessary for deliberation of a decision;[342] (ii) the arbitral board prepares a revised Terms of Reference;[343] and (iii) the arbitral board makes a decision of the case.[344] Given the OECD's approach to limit the arbitration within a MAP in which taxpayers have no or very limited participation, this provision has value as it provides taxpayers with a right to know the necessary information, which improves the taxpayer's position.

As discussed above, if the arbitral decision can bind all parties involved, including the taxpayers, it would be much more efficient. However, as pointed

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[342] OECD Sample Agreement, *supra* note 323, para. 16.
[343] *Id.*, para. 4.
[344] *Id.*, para. 16.

out earlier, the taxpayer is a party neither to a MAP nor to arbitration. Therefore, the taxpayer does not have a right to have the arbitral decision recognized or enforced in some countries even though the taxpayer has the most at stake in the whole process of the MAP and the arbitration. This is an inherent limitation that exists because arbitration is an extension of the MAP. This limitation was foreseen or intended by the OECD because the OECD intended the arbitration process to be a part of the MAP.[345]

Then, the question remains whether it would be possible to go one step further and have the arbitral decision implemented not necessarily through the MAP, but as if it were a commercial arbitral decision. Because it is the taxpayer, after all, who has the ultimate financial stake in the arbitral decision, it seems reasonable to build a mechanism that allows the taxpayers to have the final arbitral decision recognized within the treaty or the accompanying agreement. This is closely related to how the arbitration is conducted as discussed already. If the taxpayer is allowed to actively and sufficiently participate and represent its own interest in the arbitration, it may be possible to have a system in which the decision is binding on taxpayers as well as the competent authorities, which means that the taxpayer should also have the right to ask the court to recognize the arbitral decision when the competent authorities fail to implement it on their own.

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[345] 2010 OECD Model Tax Convention, *supra* note 116, Commentary to Art. 25, para. 64 (providing "[T]he resolution of the case continues to be reached through the mutual agreement procedure, whilst the resolution of a particular issue which is preventing agreement in the case is handled through an arbitration process. This distinguishes the process established in paragraph 5 from other forms of commercial or government-private party arbitration where the jurisdiction of the arbitral panel extends to resolving the whole case.").

5. Force of Arbitral Decision

There seems to be no clear and definite answer to what the status of an arbitral decision should be, and different schools of thoughts take differing positions with respect to the enforceability of arbitral decisions. The decision rendered in accordance with the EU Transfer Pricing Arbitration Convention is no exception because it seems that there has been some controversy as to the status and legal validity of the EU Transfer Pricing Arbitration Convention.

One UN document asserts that the arbitration procedure under the EU Transfer Pricing Arbitration Convention is an administrative act that forces the States to come to a mutual agreement. This school of thought deems the decision by the arbitral tribunal as only advisory in its nature, thus leaving the final decision in the hands of the contracting States involved. Such assertion is based on that the adoption of the EU Transfer Pricing Arbitration Convention reflects the member States' political decision not to give up their fiscal sovereignty.[346]

Others argue that the EU arbitration has supranational legal value and is binding under Article 220 of the Treaty of Rome, [347] which is the legal source of the EU Transfer Pricing Arbitration Convention. The UN document does not draw

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[346] *Transfer Pricing: The EC Arbitration Convention as a Dispute Resolution Mechanism*, Ad Hoc Group of Experts on International Cooperation in Tax Matters, Tenth meeting, T/SG/AC.8/2001/CRP.13, Aug. 24, 2001, UN, http://www.unpan.org/Events/Conferences/tabid/94/mctl/EventDetails/ModuleID/1532/ItemID/41/Default.
aspx (last visited Nov. 4, 2012).

[347] The Treaty of Rome, signed in 1957, is the treaty that established the European Economic Community, which later became the EU. Article 220 of the Treaty of Rome specifies that, where necessary, the member States shall enter into negotiations with each other with a view to securing the abolition of double taxation within the Community.

any conclusions on these differing views. Such school of thought is of the view that the EU Transfer Pricing Arbitration Convention involves the partial surrender of the contracting States' fiscal sovereignty. The arbitral tribunal formed is separate from the States, and its decisions are jurisdictionally supranational.[348]

Note, however, that these differences may exist in theory but not in practice as no one has challenged the nature of arbitral decisions yet, and the EU Transfer Pricing Arbitration Convention is working well as it is.

In comparison to the EU Transfer Pricing Arbitration Convention, which itself is an arbitration agreement, the OECD Model Tax Convention is a model tax treaty that merely contains a MAP clause. Thus, while the former requires the States to come up with a solution to eliminate double taxation in the context of transfer pricing, the arbitration clause under the latter is only an extension or a branch contained in the MAP clause, and only requires that the States endeavor to resolve issues. Consequently, the arbitral decisions under these two Conventions carry different force and status. While arbitral decisions under the EU Transfer Pricing Arbitration Convention are forceful enough for the academics to argue that the decision has supranational character, arbitral decisions under the OECD Model Tax Convention provides no basis for such argument. In the end, this comes down to a question of whether it would be worthwhile to explore ways that give heavier weight to arbitral decision because, if the status of the arbitral decision is as weak as the mutual agreement

[348] Chetcuti, *supra* note 294, para. 7.2.2.

in the OECD Model Tax Convention, it can end up being a waste of resources, efforts, and time.

6. Sub-Conclusion

With respect to the status of taxpayer during arbitration, the EU Transfer Pricing Arbitration Convention sheds light on how taxpayer participation may work. Taxpayers are allowed to request the opportunity to appear in front of the tribunal or submit any information that they deem relevant, etc. Thus, one avenue is to modify Article 11 of the OECD's Sample Agreement so as to allow taxpayer to participate in the arbitration process to the extent it helps the arbitrators to understand the case by adding paragraph (a) below in the right column. Also, in order to ensure that the taxpayers are given similar opportunities to appear and present their cases at the arbitral proceedings, similar to those under the EU Transfer Pricing Arbitration Convention, [349] it would be beneficial to add paragraph (b) below:

OECD SAMPLE AGREEMENT	SUGGESTED CHANGES
11. Participation of the person who requested the arbitration *The person who made the request for arbitration may, either directly or through his representatives, present his position to the*	*Rights and obligations of taxpayers* (a) The person who made the request for arbitration may, either directly or through his representatives, provide any

[349] *See* EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 7(1).

arbitrators in writing to the same extent that he can do so during the mutual agreement procedure. In addition, with the permission of the arbitrators, the person may present his position orally during the arbitration proceedings.	information, evidence or documents which seem to them likely to be of use to the arbitration board in reaching a decision, and present his position to the arbitrators. In addition, the person may present his position orally during the arbitration proceedings. (b) The concerned persons and the competent authorities of the Contracting States shall give effect to any request made by the arbitration board to provide information, evidence or documents. If the arbitration board so requests, each of the concerned persons shall appear or be represented before it.

With respect to the status of taxpayer after arbitration regarding the arbitration decision, as observed above, the arbitration procedure under the current OECD Sample agreement would be improved by (i) making the arbitration decision binding on all parties, including the taxpayer; and (ii) giving the taxpayer the right to enforce the arbitration decisions against such government that does not voluntarily implement it. Considering that the taxpayers have the most at stake

on the outcome of arbitration, it would be equitable to implement these features in the OECD Sample Agreement.

Also observed above, however, was that there are inherent limitations that renders it difficult to make the aforementioned improvements; the arbitration under the OECD Sample Agreement is a proceeding to which only the competent authorities are parties without taxpayer's participation, therefore, it would be difficult to have the taxpayer be bound by the decision, when the taxpayer is not a party to arbitration since arbitration is just a part of MAP, nor is able to present the case before the arbitral board.

A possible solution to the foregoing limitation is to vest the taxpayer with the necessary status of a party in the arbitral agreement, for example, a status equivalent to a third party beneficiary through the consent of the competent authorities.[350] Such mechanism would be achieved, for example, by including the following provision in the tax treaty. Because the following provision concerns a taxpayer's legal right, it is suggested that this provision be included in the tax treaty itself, rather than in the Sample Agreement:

> "If the competent authority against which the arbitral decision is rendered does not implement the arbitral decision and/or the mutual agreement reached within the time frame mentioned above, such competent authority shall be deemed to have agreed on the binding

[350] A third party beneficiary is a person who is not a party to an agreement, but has legal rights to enforce the agreement because the agreement is specifically intended for that person's benefit.
[350] It seems that the taxpayer has the status of third party beneficiary already because the outcome of the arbitration case is directly related to the taxpayer as it will decide whether the taxpayer will be refunded the tax or not.

> effect of the arbitration decision and the taxpayer shall be entitled to have the arbitral decision recognized in accordance with the rules of procedure of the territory where the decision is being sought to be recognized."[351]

Furthermore, in order to ensure that the competent authorities actually take actions of implementing the arbitration decision through mutual agreement procedure, the following sentence can be added to Paragraph 19 of the Sample Agreement:

> "The competent authority against which the arbitral decision is rendered shall take necessary actions, under the domestic law, to implement such mutual agreement reached within one month from the time the mutual agreement is reached."

It should be noted again that the competent authorities may not be comfortable with granting the taxpayer the ability to move forward with the arbitral decision. Also, the idea of having an arbitral decision recognized independently from a mutual agreement may be too ambitious and pre-mature as tax arbitration is in its early developmental stage. However, without a mechanism that recognizes arbitral decision as binding, the tax arbitration may not function properly due to its inherent limitation that taxpayers cannot be parties to the arbitration. It was discussed previously in this paper that the purpose of introducing tax arbitration

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[351] Such recognition would be subject to the domestic procedure as well as certain procedural defects found in arbitral proceedings to be described in the tax treaty. These circumstances are discussed in the following section in connection with New York Convention. Also, in Appendix I, this paragraph is placed in Article 25, Paragraph 7of the tax treaty, not in the arbitration agreement.

into the MAP is to encourage a better use of the MAP, and, without giving the aforementioned minimal right to the taxpayers, the tax arbitration system may hardly become operational.

C. Relationship between Domestic Remedies and Arbitration

1. OECD's Approach

The newly adopted arbitration provision of the OECD Model Tax Convention states:

> *"unresolved issues shall not . . . be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State."*

This specific language is meant to make the arbitration process more effective by foreclosing the possibility of arbitration decisions becoming redundant or conflicting with prior decisions from a court of either State.[352] The OECD lays out the following three principles with respect to the ability of the taxpayer to resort to domestic remedies as opposed to the MAP, which the OECD claims is the approach adopted by most countries:[353]

i) A person cannot pursue simultaneously the mutual agreement procedure and domestic legal remedies. Where domestic legal remedies are still available, the competent authorities will generally either require that the taxpayer agree to the suspension

[352] 2010 OECD Model Tax Convention, *supra* note 116, Commentary to Art. 25, para. 76.
[353] *Id.*, para. 76.

of these remedies or, if the taxpayer does not agree, will delay the mutual agreement procedure until these remedies are exhausted.

ii) Where the mutual agreement procedure is first pursued and a mutual agreement has been reached, the taxpayer and other persons directly affected by the case are offered the opportunity to reject the agreement and pursue the domestic remedies that had been suspended; conversely, if these persons prefer to have the mutual agreement apply, they are required to renounce the exercise of domestic legal remedies regarding the issues covered by the agreement.

iii) Where the domestic legal remedies are first pursued and are exhausted in a State, a person may only pursue the mutual agreement procedure in order to obtain relief of double taxation in the other State. Indeed, once a legal decision has been rendered in a particular case, most countries consider that it is impossible to override that decision through the mutual agreement procedure and would therefore restrict the subsequent application of the mutual agreement procedure in the other State.

The OECD's position is that if there is a decision reached by a domestic court, then no arbitration should be allowed. On the other hand, where a taxpayer has taken domestic course of remedies, but have not been rendered with a decision yet, the OECD Commentary suggests that the legal remedies be suspended pending the outcome of the MAP and that a tentative mutual agreement would be reached on the basis of that MAP decision. The taxpayer still has an option

to either (1) reject such MAP decision and resort back to the domestic remedies; or (2) accept the MAP decision and agree to abandon the domestic remedies.[354]

In summary, under the OECD Model Tax Convention, even if there is an arbitral decision rendered, the taxpayer can resort to a domestic court by rejecting the arbitral decision since such arbitral decision takes the form of decision from the MAP. This result is somewhat inefficient given that significant amount of time and resources are needed and expended for arbitration. Nonetheless, this is the limit under the current frame of having arbitration as part of the MAP and implementing the arbitral decision as mutual agreement

2. Analysis of EU Transfer Pricing Convention and U.S.-Germany Protocol

The EU Transfer Pricing Arbitration Convention seems to take a different approach in that it allows taxpayers to resort to arbitration even if there is a final judgment from domestic court. As discussed earlier, [355] it is not clear (i) which decision is binding when the taxpayer pursued both domestic remedies followed by a MAP and arbitration; and (ii) whether the taxpayer is able to resort to the domestic remedies after arbitration is completed if the taxpayer has not exhausted the domestic remedies prior to arbitration under the EU Transfer Pricing Arbitration Convention. It was also discussed that there is no need to clarify these two uncertainties because all issues that are dealt with under the

[354] *Id.*, para. 77.
[355] *See supra* Ch. 3, Part. II, Sec. C.4 for discussion about the interaction between arbitration and domestic remedies under the EU Transfer Pricing Arbitration Convention.

EU Transfer Pricing Arbitration Convention double taxation issues, and insofar as such double taxation issues are resolved, there is no incentive for taxpayers to resort to the domestic remedies.

In comparison, the U.S.-Germany Protocol is silent on this issue. It appears that the 2006 U.S.-Germany Protocol intended this matter to be discussed by the competent authorities if such situation, in which taxpayers resort to a domestic course of remedy while a MAP is progressing, arises. Note, however, that it takes a long time to go through litigation in the U.S. and in Germany and the related costs can accumulate to a significant sum of money. Therefore, in practice, it would be rare that taxpayers resort to both a domestic course of remedy and the MAP at the same time as long as the ultimate goal of the taxpayers, i.e. relief from double taxation is likely to be satisfied.

3. Sub-conclusion

Whether or not alternative course of remedies, such as domestic remedies, should be entirely waived for taxpayers before initiating arbitration would depend on the two governments' preference at the time of negotiating the tax treaty. The focus of the OECD is on whether or not the taxpayer has undertaken domestic remedies before arbitration. A different way to look at this issue is whether the taxpayer should have the ability to undertake another remedy after the arbitration decision has been rendered and formalized in the form of a mutual agreement. As long as the arbitration is a part of the MAP, the possibility of pursuing another course of remedy will remain. For the arbitration to work more efficiently and to prevent speculation of favorable answers by taxpayers, a mechanism under which the taxpayer is bound by the arbitration

decision should be considered. At the same time, it should be ensured that the affected taxpayer (i) is afforded sufficient protection in the arbitration proceeding; (ii) is not deprived of basic rights; and (iii) is secured of the result that eliminates double taxation. There may be certain limited occasions that warrant taxpayers to resort to international arbitration when the domestic remedies are proven to be insufficient in eliminating double taxation or because the domestic remedies were not consistent with the relevant tax treaty. This would be a matter to be decided by the two governments, and among the feasible options are: (i) to disallow arbitration once domestic course of remedies have been sought, which is the approach taken by the OECD; (ii) to allow arbitration even after domestic course of remedies have been sought in limited circumstances; or (iii) to require waiver of the domestic course of remedies for arbitration. In such case, it is understandable that the taxpayer may want to pursue an international course of remedy. In any case, however, it would not be sensible to allow the taxpayer to concurrently pursue both international arbitration and domestic remedy. If the governments take option (ii), the relevant provision would read as follows:

OECD MODEL TAX TREATY	SUGGESTED CHANGES
Article 25, Paragraph 5. *"unresolved issues shall not . . . be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State."*	These unresolved issues shall not, however, be submitted to arbitration if a final decision on these issues has already been rendered by a court or an administrative tribunal of either State. Notwithstanding the

	previous sentence, the issues or case shall be allowed to be submitted to arbitration if the final decision rendered by a court or administrative tribunal of either State does not fully relieve the affected taxpayer of double taxation or such decision is not consistent with the tax treaty."

While the original language by the OECD implies no arbitration where there has been a court decision already, the language of the alternative options would effectively eliminate the possibility of taxpayer resorting to domestic remedies after the arbitration, while still leaving domestic remedies as an available option before arbitration.

D. Relationship with MAP

1. OECD's Perspective

The OECD Sample Agreement is silent on whether, once an arbitration proceeding starts, the two competent authorities are free to continue or stay the MAP. Nonetheless, the OECD Commentary explains that the arbitration is an extension of the MAP and the competent authorities should continue their discussion of the case while "certain issues" are being resolved through arbitration.[356] While it is understandable that some issues are better-suited for

[356] OECD Commentary Article 25, paragraph 64.

resolution by arbitration while others by the MAP, there may be a conflict with respect to sending only certain issues to arbitration while the case itself is undergoing the MAP, because the issues to be dealt with in the MAP may depend on the outcome of the issues referred to the arbitration. Perhaps, one of the competent authorities would refuse to continue the discussion for this reason.

2. EU Transfer Pricing Arbitration Convention

The EU Transfer Pricing Arbitration Convention is silent on whether the competent authorities may continue the MAP. Further, it does not require the arbitration decision to form a mutual agreement. It seems that such clarification on the relationship between a MAP and arbitration is not necessary as the EU Transfer Pricing Arbitration Convention provides a wide discretion to the competent authorities to reach an agreement to resolve double taxation. As long as double taxation issue is resolved, the competent authorities are allowed to deviate from the opinion of the advisory commission.[357]

3. U.S.-Germany Protocol

The 2006 U.S.-Germany Protocol specifically allows the two competent authorities to reach a mutual agreement to resolve a case, even while arbitration is in progress—if a mutual agreement is reached, however, pending arbitration would be terminated. If the concerned person wants to stay, i.e., stop, the arbitration proceeding, such concerned person must withdraw the request for

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[357] EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 12(1)-(2).

the MAP entirely.[358] Furthermore, the U.S. and Germany agreed to limit the scope of determination in the mandatory arbitration to the determination of the amount of income, expense or tax reportable to the states involved in the 2006 Protocol.[359] The presence of this limitation implies that the two governments realized that not all issues are fit for resolution by arbitration.

4. Sub-conclusion

The 2006 U.S.-Germany Protocol offers a good example for improving the OECD approach to provide procedural clarity and better-accommodate the needs of the countries involved. The OECD Model Tax Convention seems to lack such clarity in terms of specifying the issues or cases that are to be referred to arbitration. This seems cost-efficient and reasonable particularly for cases where arbitration proceeding is initiated due to the two-year limit while the two competent authorities continue to progress with the MAP. Having an option to resolve a case quicker than arbitration would be beneficial to both the competent authorities and the taxpayer. However, the taxpayer should be given the comfort that the mutual agreement reached during the arbitration proceeding would provide relief to the taxpayer, and that the taxpayer, if not satisfied, would be entitled to ask for continuation of the arbitration in certain circumstances similar to where taxpayers are allowed to resort to domestic remedies after arbitration.[360] The OECD provision can achieve this by, for example, adding a new sub-paragraph to Paragraph 5 of Article 25 as follows:

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[358] 2006 Protocol, *supra* note 329, Art. 16, Para. 22(c).
[359] *Id.*, at Art. 16, Para. 22(b).
[360] The first sentence of the proposed sample provision is also included in the U.S. – Germany treaty. The second sentence is proposed so that the taxpayer is still entitled to continuation of arbitration proceeding even though the taxpayer does not accept the mutual agreement reached

> "Notwithstanding the initiation of the arbitration proceeding, the competent authorities may reach a mutual agreement to resolve a case and terminate the arbitration proceeding if such mutual agreement is accepted by the person who requested arbitration. The concerned person may request continuation of arbitration proceeding when (i) double taxation is not fully resolved through a mutual agreement procedure; or (ii) if it believes that the mutual agreement is not consistent with the Convention."

E. The Agreement to Arbitrate

The OECD seems to have envisioned binding the parties to arbitration through a separate agreement alongside the tax treaty. In this regard, the OECD provides the OECD Sample Agreement in its Commentary to Article 25. However, as discussed above, the OECD intended the arbitration to be a part of the MAP rather than an independent dispute resolution mechanism which we see in general commercial arbitrations. Given that the Sample Agreement provides procedural rules to be followed when the unresolved issues are submitted to arbitration, the OECD Sample Agreement is not an agreement to arbitrate, but is a set of "rules of procedure" that lists out the rules to follow when the case or issues are referred to arbitration. The OECD itself noted in the Commentary that the OECD's Sample Agreement is intended to provide

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during the arbitration proceeding. Including this provision in Article 5 of the treaty, rather than in the arbitration agreement, should be also considered as it concerns the basic rights of taxpayers and the competent authorities in a MAP, though I included this provision in the arbitration agreement for now. See Appendix I, Art. 5, Para. 6(a).

structural and procedural rules to be followed in arbitration[361], therefore, it is more appropriate to call it "Rules of Procedure" rather than "arbitration agreement" in order to clearly convey the message that this is a set of procedure to follow in case of arbitration.

OECD MODEL TAX TREATY	SUGGESTED CHANGES
Mutual Agreement on the Implementation of Paragraph 5 of Article 25	Rules of Procedure

Furthermore, the EU Transfer Pricing Arbitration Convention includes important aspects of the arbitration within the Convention itself, while the procedural rules are provided in the Code of Conduct. The tax treaty between the U.S. and Germany also includes procedural rules as part of the tax treaty itself and the 2006 Protocol. It seems that incorporating certain aspects of the procedural matters into the tax treaties, or alternatively at least executing a separate set of procedural rules along with the tax treaty, would be time-efficient as it would remove the necessity for the State to go through negotiation of separate arbitration agreement. If it is not feasible to include such procedural rules within a tax treaty or to execute along with a tax treaty, it is suggested that such procedural rules are agreed at the time a MAP is initiated. This would help to expedite the arbitration process, particularly when the arbitration is to start automatically after two year period from the time MAP is initiated, as suggested above.

[361] OECD Commentary to Article 25, Paragraph 85.

F. Subject Matter of Arbitration

The ICC Draft Bilateral Convention Article for Arbitration in International Tax Matters ("ICC Tax Arbitration Article Draft")[362] provides some guidance in determining the subject matter of arbitration. To be more specific, it provides that arbitration shall be held in the event that (i) the competent authorities failed to reach a solution within two years; or (ii) the taxpayer considers that the solution reached is not in accordance with the relevant tax treaty.[363] From the above, it is clear that the ICC contemplated the subject matter of tax treaty arbitration to include matters that are "not in accordance with the treaty", such as matters that are in violation of tax treaty. This seems reasonable given that domestic taxation may violate a tax treaty even if it does not result in double taxation and when it does, taxpayers have a legitimate interest in proper treaty application.

The EU Transfer Pricing Arbitration Convention provides for more specific condition that, for the matter to proceed to arbitration, competent authorities must fail to reach an agreement that eliminates double taxation.[364] This condition is understandable because (i) the EU Transfer Pricing Arbitration

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[362] *See* Int'l Chamber of Commerce [ICC], Commission on Taxation, *Arbitration in International Tax Matters, Draft Bilateral Convention Article*, Doc. No 180/455 (2002) [hereinafter *ICC Tax Arbitration Draft*]. The Commission on Taxation of the ICC prepared a Policy Statement concerning Arbitration in Tax Matters dated May 3, 2000. In order to assist in the implementation of arbitration in tax matters in conformity with the guidelines established in the ICC Policy Statement, the Commission has prepared a model article, which could be adopted in bilateral taxation conventions based on the OECD Model Tax Convention though it could, with appropriate modifications, be adopted in bilateral tax conventions based on other models. This Draft Article also has commentary.

[363] *ICC Tax Arbitration Draft*, *supra* note 362, para. 1.

[364] EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 7

Convention is limited to transfer pricing issues; and (ii) almost all transfer pricing issues involve double taxation issues. In other words, if the only condition required for arbitration were the existence of double taxation, almost all transfer pricing cases would end up in arbitration—hence, such more strict condition is appropriate.

The mandatory arbitration provision agreed by the U.S. and Germany contemplates an arbitration of the entire case,[365] though when there are multiple issues in a given case, each issue is to be addressed separately.[366] This firm yet expansive position taken by the U.S. and Germany, compared to the OECD approach, seems to come from that the arbitration is available only for certain specified subject matters[367] and with limited scope of determination.[368]

In comparison, the approach taken by the OECD limits the type of disputes that can be brought to arbitration to those that arise under paragraph (1) of Article 25, i.e. "taxation not in accordance with the provision of this Convention." This necessarily excludes from arbitration the interpretation cases that arise under paragraph (3) of Article 25, though competent authorities are allowed to take such issues to arbitration if agreed. Also, the language of the OECD Model Tax Convention allows arbitration when there are unresolved issues that prevent two

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[365] The first sentence of the new provision on the mandatory arbitration as contained in the 2006 Protocol, *supra* note 329, starts with a phrase "In respect of any case . . .," which implies that the entire case is to be referred to arbitration.

[366] 2008 MOU, *supra* note 329, para. 11.

[367] The 2006 Protocol, *supra* note 329, designates residence related to a natural person, permanent establishment, business profits, associated enterprises and royalties as the areas that the arbitration is to be used unless the two authorities agree otherwise.

[368] The U.S – Germany Income Tax Treaty limits arbitration to cases or issues related to residence, permanent establishment, business profits, associated enterprises (transfer pricing) and royalties, which is narrower than the scope of subject matter under the OECD version.

competent authorities from reaching a mutual agreement on a specific case, i.e., the purpose of the arbitration is not to resolve the whole case, but to resolve outstanding "issues" that prevent the case from being resolved by mutual agreement.[369,370]

This attitude by OECD in trying to limit the subject matter of arbitration to "unresolved issue(s)" rather than the "entire case" seems to demonstrate the OECD's intention to confine the operation of arbitration within the framework of the MAP, which would cause arbitration to be merely a part of the MAP. This is not surprising given the adverse stance that it took against arbitration (and advocating of the MAP on behalf of governments) when the business community raised a voice for the need to improve or find an alternative to a dysfunctional MAP until the early 1990s.[371] Furthermore, limiting the subject matter of arbitration to unresolved issues may lead to arbitration not being an option for taxpayers because taxpayers would not know which issues are preventing the case from being resolved due to the fact that taxpayers are completely excluded from the MAP, as discussed above.[372]

While this limitation inherent to the arbitration scheme under the current OECD model would continue to exist so long as it remains to be a part of the MAP, once the arbitration is initiated, there is no reason to disallow the taxpayer from

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[369] 2010 OECD Model Tax Convention, *supra* note 116, Commentary to Art. 25, para. 64.

[370] Nonetheless, the OECD allows the entire case to be referred to arbitration when the two competent authorities agree to do so, but this concession is made in the Explanations for the OECD Sample Agreement. OECD Sample Agreement, *supra* note 323, Explanations, para. 9. The fact that this concession is made in the Explanations for the OECD Sample Agreement seems to indicate the OECD's unwillingness to allow the entire case to be referred to arbitration.

[371] *See* OECD 1984 Report, *supra* note 45, Ch. 3, Paras. 54-63 for the OECD's prior position against adopting arbitration.

[372] *See* Ch. 2, Part II for discussion on taxpayers being excluded from the MAP.

referring the entire case to arbitration, especially when the MAP fails to render an outcome that serves the interests of the taxpayer. As such, by modifying Article 25 of the OECD Model Tax Convention to include the following language, the interests of taxpayers and the spirit of tax arbitration would be better-served:

> "[A] case shall be eligible for arbitration if it is a case (i) that would result in taxation which is not in accordance with the provisions of this Convention; or (ii) that the competent authorities agree to be suitable for determination by arbitration."

III. Analysis of Procedural Matters

A. Terms of Reference

1. Definition of Terms of Reference

Terms of Reference, which used to be a unique feature existing under the procedural rules of the ICC, is a pre-trial arrangement that sets out detailed rules of conduct in the pre-main proceeding stage.[373] Under the ICC rules, once the arbitration tribunal is formed, documents and records of the case are delivered to arbitrators and the arbitrators prepare the Terms of Reference summarizing the issues and arguments as well as procedural aspects of arbitration, including the location of arbitral meetings, the language to be used,

[373] Petrochilos, *supra* note 238, at 215.

and applicable laws.[374] Additional points may also be included at the discretion of the arbitration tribunal or if requested by the parties. These might include directions as to providing evidence, exchange of witness statements, perhaps witness conferencing, form for submission of documentary evidence and other notices between the parties and the Tribunal, and often a notation allowing the Chair to issue procedural directions on behalf of the other arbitrators in the case of a three-person Tribunal.

The ICC originally deemed the Terms of Reference necessary since many civil law systems, the French in particular, did not recognize as binding an agreement to arbitrate entered into by the parties prior to the existence of a dispute, such as an arbitration clause in their underlying commercial contract. Instead, such civil law systems required that the parties agree upon arbitration only after a dispute had materialized,[375] designate the forum, and identify the issues to be adjudicated.[376] Thus, the Terms of Reference was originally intended to serve as a compromise, and the practice has continued in ICC arbitrations to this date, despite the fact that most civil law jurisdictions, including France, now recognize pre-dispute agreements to arbitrate as binding on the parties. Therefore, the primary purpose of the Terms of Reference today is to define the scope of the arbitration and identify the issues to be decided.[377]

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[374] KIM, GAP YOO, INTERNATIONAL ARBITRATION HANDBOOK: ICC ARBITRATION (김갑유, 국제중재 Handbook: ICC 중재편 법무법인태평양); ICC Arbitration Rules, Arbitration and ADR Rules, Art. 23 at 15-16 (2012)

[375] These agreements were known as "compromises."

[376] A *compromise* is a formal document, executed in common by nations submitting a dispute to arbitration which defines the matter at issue, the rules of procedure, the powers of the arbitral tribunal, and the principles for determining the award.

[377] Karen Mills, Terms of Reference: An Arbitrator's Perspective, KarimSyah Law Firm, Jakarta, Jan. 31, 2005.

2. OECD Approach

Paragraph 3 of the Sample Agreement reads as follows:

> *3. Terms of Reference*
> *Within three months after the request for arbitration 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 will constitute the "Terms of Reference" for the case. Notwithstanding the following paragraphs of this agreement, the competent authorities may also, in the Terms of Reference, provide procedural rules that are additional to, or different from, those included in these paragraphs and deal with such other matters as are deemed appropriate.*

The OECD Commentary explains that the competent authorities are to agree on the questions to be resolved by the arbitration panel, and that such agreed questions will constitute the Terms of Reference, which, in turn, establishes the jurisdictional basis for the issues. This is misleading and inaccurate both in terms of the sequence of events and the use of terminology. Terms of Reference is executed only after the arbitration tribunal has been constituted and vested with jurisdiction to hear the dispute. If the Terms of Reference itself were the instrument that granted such jurisdiction, the arbitration tribunal could not be constituted until after the parties execute the Terms of Reference. The jurisdiction to hear a dispute is derived from the original agreement of the parties to refer such dispute for commercial cases, but the jurisdiction in tax

treaty arbitrations would be derived from the underlying tax treaty.[378] It is possible that the Terms of Reference can provide specific jurisdiction to arbitrators to hear specific issues, which seems to be what the OECD truly intended. In such case, the Terms of Reference should be prepared by the arbitrators themselves based on the submissions made by the parties, or at least in conjunction with the parties. Defining the specific jurisdiction is important because arbitration is by definition consensual and such specific jurisdiction will determine the arbitrators' power afforded by the parties' consensus.

3. Comparison with Pre-Hearing Conference

Tax treaty arbitration, involving two governments, would more closely resemble the ICSID arbitration (i.e., investor – state arbitration) than a commercial arbitration under the ICC. The ICSID procedural rules do not require Terms of Reference. Instead, Procedural Orders, Preliminary Procedural Consultation and Pre-Hearing Conference seem to be equivalent to the Terms of Reference of the ICC. There is no requirement that these must be in writing.[379, 380] As such, it is not clear how the OECD came to adopt the Terms of Reference in the Sample Agreement when the ICSID deems it unnecessary.

The Sample Agreement suggested by the OECD already sets forth necessary procedures and administrative matters that need to be determined by the parties prior to the arbitration proceedings. If the purpose of the Terms of Reference

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[378] *Id.*, at 12.

[379] ICSID Rules of Procedure for Arbitration Proceedings, Rule 19; 20; 21, ICSID/15 (Apr. 2006) [hereinafter ICSID Arbitration Rules]. *See infra* Appendix V for the comparison of the ICC Rules and ICSID Rules in terms of pre-proceeding arrangements.

[380] *See generally infra* Appendix V.

were to serve as an instrument under which the parties agree concerning the issues to be resolved, then it would not need to take the form of "Terms of Reference." After all, the parties already have been arguing over the issue for two years, and would be familiar with the issues already. It would be the arbitrators who would need to study the issues; therefore, it would be sensible for arbitrators to summarize the case based on the information submitted, and have that summary acknowledged by the parties. If such summarizing process is too cumbersome, then a simpler procedure, such as a pre-hearing conference, should be considered instead. In fact, a pre-hearing conference may serve the needs of the arbitrators, i.e. to understand the issues, and those of the parties, i.e. to agree on the issues, all at once. Furthermore, such pre-hearing conference can be an opportunity for conciliation between the parties with arbitrators acting as a moderator. Under the ICSID Arbitration Rules, either the parties or the presiding arbitrator may arrange for such pre-hearing conference in which all arbitrators and parties gather together for an exchange of information, stipulation of uncontested facts in order to expedite the proceeding, and consideration of the issues in dispute with a view to reaching an amicable settlement.[381]

4. Sub-Conclusion

The OECD contemplated that a separate agreement is needed to "establish the mode of application of the arbitration process"[382] and provided the Sample Agreement as guidance. The Sample Agreement achieves the goal of providing general guidance to certain extent, but also leaves a lot of uncertainty.

[381] ICSID Arbitration Rules, *supra* note 379, Rule 21.
[382] OECD Sample Agreement, *supra* note 323, para. 1.

Furthermore, the OECD's choice to use the term "Terms of Reference" seems to have created confusion because the same term is already used by the ICC in a certain defined way. As discussed above, it creates an issue in terms of jurisdiction, and its utility does not seem to justify the time (up to 4 months) and efforts necessary to execute one, particularly in case a separate agreement is to be entered into for the arbitration itself. Most of all, it should be prepared by the arbitral panel, not by the competent authorities.

As an alternative, suggested herein is a pre-hearing conference to be held after the arbitrators have been appointed. Such pre-hearing conference would (i) save time; (ii) prevent jurisdictional issue associated with Terms of Reference; (iii) allow the parties and arbitrators to agree on the subject matter and the procedural rules to adhere to during the process; and (iv) provide an opportunity to settle before actual hearings take place.

OECD SAMPLE AGREEMENT	SUGGESTED CHANGES
3. Terms of Reference *Within three months after the request for arbitration 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*	*Pre-Hearing Conference* (a) Within one month after all the arbitrators have been appointed as provided in paragraph 3 above, the Chair shall communicate to the competent authorities and the person who made the request for arbitration in writing that (i) arbitration tribunal has been

will constitute the "Terms of Reference" for the case. Notwithstanding the following paragraphs of this agreement, the competent authorities may also, in the Terms of Reference, provide procedural rules that are additional to, or different from, those included in these paragraphs and deal with such other matters as are deemed appropriate.	formed; (ii) summary of the issues (or the case) to be arbitrated based on the information received by arbitrators; and (iii) request for a pre-hearing conference, if necessary, so that all arbitrators, competent authorities and concerned persons gather together for an exchange of information, stipulation of uncontested facts and consideration of the issues (or case) in dispute with a view to reaching an amicable settlement. (b) If a settlement is reached out of the pre-hearing conference mentioned above, such settlement shall constitute an arbitration decision.

B. Arbitral Tribunal

1. Selection and Qualification of Arbitrators

Like commercial arbitration, constituting the tribunal and appointing the arbitrators are some of the most important matters in tax arbitration as well. International commercial arbitration rules usually provide for either a sole arbitrator or a three member tribunal.

A single arbitrator, though may be simpler and more cost-efficient, is not likely to be acceptable in tax arbitration due to the size of the disputed amount (as the taxpayer would not have asked for a MAP if the amount involved was not substantial enough to justify undergoing the rather cumbersome MAP process) and the risk of biased arbitrator.[383] A three-member tribunal, on the other hand, would make the arbitration process more time-consuming, but arbitrators would be more careful with their reasoning as they would need to justify their conclusions during the deliberations with other arbitrators.

In comparison, the advisory commission under the EU Transfer Pricing Arbitration Convention is at minimum a five-member tribunal, comprised of a representative of each competent authority involved in the dispute,[384] a chairperson selected by the representatives, and an even number of independent persons.[385] There is, however, no limit as to the number of members elected for advisory commission. The number of members is to be decided and agreed by the States as having too many arbitrators may make arbitration process expensive and slow.

Another issue associated with the selection of arbitrators is to determine who qualifies as an arbitrator, or, put differently, who should be excluded from the

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[383] Tillinghast, *supra* note 331, at 91.

[384] The EU Transfer Pricing Arbitration Convention prescribes two representatives from each party, but the competent authorities can agree to one from each. *See* EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 9(1).

[385] *See supra* Ch. 3, Part II, Sec. C.1.

arbitration panel. Two sets of qualifications must be considered: independence and expertise.[386]

Independence

The Introductory Note of the International Bar Association ("IBA") Rules of Ethics for International Arbitrators 1987 begins with a statement that the International arbitrators should be impartial, independent, competent, diligent and discreet. The criteria for assessing questions relating to bias are impartiality and independence. Partiality arises when an arbitrator favors one of the parties, or where he is prejudiced in relation to the subject-matter of the dispute. Dependence arises from relationships between an arbitrator and one of the parties, or with someone closely connected with one of the parties.[387]

For example, an arbitrator should not be a partner at a firm or an affiliate of a firm that represents a party or its affiliate, or serves on the board of a party, since any current direct or indirect business relationship between an arbitrator and a party, or with a person who is known to be a potentially important witness, will normally give rise to justifiable doubts as to a prospective arbitrator's impartiality or independence.[388] Moreover, international arbitrators would normally avoid any unilateral communications regarding the case[389], except in connection with selection of the presiding arbitrator.[390]

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[386] Park, *supra* note 13, at 816.
[387] IBA, Rules of Ethics for International Arbitration 1987, Article 3.
[388] *Id.*, Article 3.3.
[389] *Id.*, Article 5.3.
[390] If a party-nominated arbitrator is required to participate in the selection of a third or presiding arbitrator, it is acceptable for him to obtain the views of the party who nominated him

The OECD Sample Agreement specifically allows any person including a government official of a contracting state to be an arbitrator.[391] The OECD explains that it will be in the interests of the competent authorities to have qualified and suitable persons act as arbitrators.[392] On the other hand, the U.S.-Germany Income Tax Treaty specifically forbids government employees (including former employees who had their last employment in the government within two years) from being an arbitrator.[393] The U.S. and Germany takes this position because bias can be easily created in the very likely event that each competent authority appoints one of their current or former government employees to represent its interest. Similar to the U.S.-Germany Income Tax Treaty, the EU Transfer Pricing Arbitration Convention also does not allow a government official who works for the tax authority by providing the competent authority a right to object to the appointment of an arbitrator under certain circumstances, e.g. if the person works for the tax administration.[394] A government official, particularly if such government official works for the tax authority, would be equivalent to a person who has a business relationship in international commercial or investment arbitrations as discussed above, therefore, give rise to justifiable doubts as to a prospective arbitrator's impartiality or independence because government official are inherently partial and dependent. In any event, disclosure should be made of any material links to

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as to the acceptability of candidates being considered. IBA Rules of Ethics for International Arbitration, Article 5.2.

[391] OECD Sample Agreement, *supra* note 323, Art. 7.

[392] OECD Sample Agreement, *supra* note 323, Explanations, para. 15.

[393] 2008 MOU, *supra* note 329, para. 6(d).

[394] EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 9. This provision forbids a person from becoming an arbitrator if such person works for the taxpayer, or if there is any other reason sufficient to cast doubt on the person's independence.

either Contracting State or the taxpayer. The presiding arbitrator should be required to be of a nationality of a third state other than the two Contracting States.

Expertise

There are two areas that the expertise may make the difference; tax expertise and arbitration expertise. Ideally, the Tribunal should be constituted by individuals with substantial experience in the area of tax, whether as lawyers, accountants or professors. In many cases, however, the need for other types of expertise may require access to a pool other than fiscal practitioners and academics. For example, in some cases an economics background will be of importance. At the same time, arbitration raises difficult procedural questions that may determine the success of the case, and often times there is no universally accepted answer in a legally heterogeneous world. When a large amount of dollars is at issue and when arbitrators have the discretion to design flexible methods appropriate to each case, someone on the tribunal must have experience addressing the key procedural matters on which national practices differ. Consequently, it is required that at least one member of the tribunal possess experience in conducting arbitration. There are a number of procedural issues[395] that can arise during the process, and for the sake of balance, at least

[395] Park, *supra* note 13, at 818, lists a number of potential procedural questions that may come up during the arbitration including (a)if one party makes the equivalent of a motion for summary judgment, requesting expedited disposition of a particular issue without evidentiary hearings, How should the arbitrators handle such motion? (b) If the chair person expresses an opinion on the outcome too early, has he/she "prejudged" the case permitting the chairman's removal for bias? (c) Should direct testimony be pre-filed in the form of written statements? (d) Should briefs be sequential or simultaneous? (e) Should experts testify together in a "dual" fashion, debating each other's submissions? (f) What happens when an arbitrator knows a

one of the arbitrators, preferably the chair person, should have experience in conducting major international litigations or arbitrations.[396] For example, the EU Transfer Pricing Arbitration Convention imposes a higher standard for the presiding arbitrator (or chairman) by requiring the person to be a former judge or a person with legal training.[397] Specific guidance is always helpful and the parties and the OECD should consider incorporating a similar provision regarding the qualification of arbitrators into the arbitration agreement.

As discussed, like commercial arbitrations, tax arbitrations require expertise, technicality, and experience. At the same time, arbitration requires impartiality and neutrality. Representatives of the relevant competent authorities may be eligible for the tribunal, but their potential interest in the outcome must be weighed against their expertise for the purpose of independent and impartial outcome of the arbitration. The OECD Commentaries recommend that each competent authority selects one arbitrator of their choices. However, this arbitrator chosen by the competent authority is likely to represent the interest of that competent authority[398] unless such arbitrator is chosen from the list of arbitrators registered with the international institution overseeing the arbitration process. Currently, there is no such international institution for tax arbitrations,[399] and there should be at least one international institution to start

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witness socially or professionally? (g) May the tribunal appoint its own experts, or must it rely on those hired by the parties, etc.

[396] The OECD also emphasizes the importance of such experience by recommending that the chair person should have experience if procedural, evidentiary and logistical issues that arise in arbitral proceedings. OECD Sample Agreement, *supra* note 323, Explanations, para. 15.

[397] EU Transfer Pricing Arbitration Convention, *supra* note 255, Art. 9(5).

[398] Michael J. McIntyre, *Comments on the OECD Proposal for Secret and Mandatory Arbitration of International Tax Disputes*, 7 FLA. TAX REV. 622, 638 (2006).

[399] Examples of such international institutions include the International Center for the Settlement of Investment Disputes ("ICSID"), the International Fiscal Association ("IFA") and

collecting a list of potential arbitrators for tax arbitrations, whether potential candidates come from academics or from practitioners, when the use of arbitration as a mode to resolve international tax disputes is gaining its momentum. The hearing of tax disputes by experts independent of the tax authorities is one of the major advantages of arbitration over the MAP, so long as such arbitrators can be found and are willing to serve as arbitrators. At this time, the OECD seems to qualify the most as an institution to administer the list of qualifying arbitrators because OECD was the first institution to endorse the mandatory arbitration as a dispute resolution method for international tax disputes.[400] The suggested changes are laid out below:

OECD SAMPLE AGREEMENT	SUGGESTED CHANGES
5. Selection of arbitrators *Within three months after the Terms of Reference have been received by the person who made the request for arbitration or, where paragraph 4 applies, within four months after the request for arbitration has been received by both competent authorities, the competent authorities shall each appoint one arbitrator.*	*Selection of arbitrators* (a) Unless the competent authorities of both contracting states and the concerned persons agree otherwise, the Arbitral Tribunal shall be composed of three members. Within three months after the second competent authority is in receipt of a notice of

the International Court of Arbitration of the International Chamber of Commerce ("ICC"). Each institution has its own characteristics such as being influenced either by the private or the government sector, and etc.

[400] In fact, the OECD Commentaries recommends that the OECD CTPA selects the chairperson in case the two competent authorities do not agree on the appointment of a chairperson for the arbitration panel.

Within two months of the latter appointment, the arbitrators so appointed will appoint a third arbitrator who will function as Chair. If any appointment is not made within the required time period, the arbitrator(s) not yet appointed shall 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. The same procedure shall apply with the necessary adaptations if for any reason it is necessary to replace an arbitrator after the arbitral process has begun. Unless the Terms of Reference provide otherwise, the remuneration of all arbitrators .... [the mode of remuneration should be described here; one possibility would be to refer to the method used in the Code of Conduct on the EC Arbitration Convention].	arbitration from the first competent authority, the competent authorities shall each appoint one arbitrator. (b) Within one month of the appointment, the arbitrators so appointed will appoint a third arbitrator who will function as the Chair. (c) If any appointment is not made within the required time period, the arbitrator(s) not yet appointed shall 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 one of the competent authorities or the person who made the request for arbitration. The same procedure shall apply with the necessary adjustments if, for any reason, it is necessary to replace an arbitrator after the arbitral process has begun
7. Eligibility and appointment of	*Eligibility of arbitrators*

arbitrators *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. An arbitrator will be considered to have been appointed when a letter confirming that appointment has been signed both by the person or persons who have the power to appoint that arbitrator and by the arbitrator himself.*	(a) Any person may be appointed as an arbitrator, unless one of the following applies: (i) the person belongs to or is working on behalf of one of the tax administrations concerned; (ii) person has, or has had, a large holding in or is or has been an employee of or adviser to the presenter or concerned persons; (iii) the person does not offer a sufficient guarantee of objectivity for the settlement of the case or issues to be decided. (b) Each individual appointed to serve as an arbitrator shall disclose links to either contracting state or the taxpayer or any other concerned person that might create reasonable doubts about the individual's ability to render a fair decision. (c) An arbitrator shall be considered to have been appointed when a letter confirming that appointment has been signed

	both by the competent authority who has the power to appoint that arbitrator and by the arbitrator himself. (d) The Chairman must possess the qualifications required for appointment to the highest judicial offices in his country, be a juris scholar of recognized competence or a lawyer fluent in [languages appropriate for both parties], shall not have the nationality of either contracting states and shall be independent of the governments of both contracting states and the concerned persons. The Chairman shall have substantial experience in international arbitration and/or international taxation.

2. The Appointing Authority

In some instances a "list method" is used, whereby the institutional appointing authority sends each side several names, and invites the parties to strike those who are unacceptable and rank the remaining candidates in the order of preference. In this case, the parties are invited to choose among the candidates remaining on both lists. If the parties fail to agree on the list, the institutional

authority makes the appointment.[401] The following discussion will introduce a few appointing authorities used in international commercial arbitrations with brief introduction of each.

Permanent Court of Arbitration ("PCA")[402]

The PCA consists of a panel of jurists designated by each country acceding to the Convention from which the members of each arbitral tribunal might be chosen. Therefore, members of the Court are potential arbitrators appointed by member states. Each member state is entitled to nominate up to four persons "of known competency in questions of international law, of the highest moral reputation and disposed to accept the duties of arbitrators" as "Members of the

[401] For Example, Commercial Arbitration Rules and Mediation Procedures of American Arbitration Association provides, R- 11: Appointment from National Roster, that: " (a) If the parties have not appointed an arbitrator and have not provided any other method of appointment, the arbitrator shall be appointed in the following manner: The AAA shall send simultaneously to each party to the dispute an identical list of 10 (unless the AAA decides that a different number is appropriate) names of persons chosen from the National Roster. The parties are encouraged to agree to an arbitrator from the submitted list and to advise the AAA of their agreement.
(b) If the parties are unable to agree upon an arbitrator, each party to the dispute shall have 15 days from the transmittal date in which to strike names objected to, number the remaining names in order of preference, and return the list to the AAA. If a party does not return the list within the time specified, all persons named therein shall be deemed acceptable. From among the persons who have been approved on both lists, and in accordance with the designated order of mutual preference, the AAA shall invite the acceptance of an arbitrator to serve. If the parties fail to agree on any of the persons named, or if acceptable arbitrators are unable to act, or if for any other reason the appointment cannot be made from the submitted lists, the AAA shall have the power to make the appointment from among other members of the National Roster without the submission of additional lists.

[402] The PCA was established by the Convention for the Pacific Settlement of International Disputes, concluded at The Hague in 1899 during the first Hague Peace Conference.

Court." Members of the Court are appointed for a term of six years, and their appointments can be renewed.[403]

The PCA can assist in the selection of arbitrators, and may be called upon to designate or act as an appointing authority. As an appointing authority, the PCA was initially conceived for state-to-state arbitration. Now, the PCA has adopted rules for use in disputes involving private parties. In appropriate cases, the PCA could designate an institution with fiscal expertise (such as the OECD or the International Fiscal Association) to make the appointment. The Arbitration Rules drafted by the United Nations (the "UNCITRAL Rules") provide that, if all parties have not agreed on the choice of an appointing authority, or if the appointing authority fails to appoint an arbitrator within the time period provided by the Rules, any party can request the Secretary-General of the PCA to designate the appointing authority.[404]

International Chamber of Commerce ("ICC")[405]

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[403] Korea became a member state of the PCA on February 21, 2000, and currently has the following four persons as jurists:

(1) Park, Soo Gil, Professor at Korea University, Graduate School of International Relations;

(2) Kim, Chan Kiu, Professor at Kyung Hee University, College of Law. Appointed in 2006;

(3)Lee, Jang Hie: Professor at Hankuk University of Foreign Studies, College of Law; and

(4)Mok, Young Joon; Judge at the Constitutional Court of Korea. Appointed in 2006.

[404] United Nations Commission on International Trade Law [UNCITRAL] *Arbitration Rules*, G.A. Res. 2205 (XXI) art. 6, Paras. 2, 4 (Dec. 6, 2010).

[405] The International Chamber of Commerce was founded in 1919 to serve the world's businesses by promoting trade and investment, open markets for goods and services, and the free flow of capital. It is the largest global business organization with national memberships from more than 90 countries as well as stand-alone memberships by business organization in

Even though ICC has a Commission on Arbitration, ICC's arbitration body is the International Court of Arbitration,[406] which was created in 1923 and became one of the recognized arbitration institutions with its own set of arbitration rules. Parties who wish to organize ad hoc arbitration proceedings can request the ICC to assist in the constitution of the Arbitral Tribunal.[407] The members of the ICC International Court of Arbitration are appointed for a three-year term.[408]

International Court of Justice ("ICJ")[409]

The ICJ is composed of 15 judges elected to nine-year terms of office by the United Nations General Assembly and the Security Council. All States that are parties to the Statute of the Court have the right to propose candidates. These proposals are made not by the government of the State concerned, but by a group consisting of the members of the Permanent Court of Arbitration

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countries in which there is no national ICC committee yet. The ICC Commission on Arbitration has over 500 members from 90 countries, including partners in international law firms, in-house counsel, law professors, experts in different dispute resolution services, and trade executives in member companies and international organizations.

[406] It is not a judicial court, but is an institution within the ICC that handles arbitration proceedings, and etc.

[407] Such request requires non-refundable payment of US$3,000. *See for details* http://www.iccwbo.org/court/arbitration/id4600/index.html (last visited Jan. 25, 2012).

[408] In Korea, Kim, Kap-You and Chang, Seung Wha are currently members of the ICC's International Court of Arbitration.

[409] The ICJ was established as a judicial organ of the League of Nations in accordance with Article 14 of the Covenant of the League of Nations. When first established in 1920, it was a Permanent Court of International Justice ("PCIJ"), which was to hear and determine any dispute of an international character submitted to it (jurisdiction in contentious cases) as well as to give an advisory opinion upon any dispute or question referred to it by the Council or by the Assembly (advisory jurisdiction). (The Covenant of the League of Nations art. 14. L.N.T.S.) In 1946, PCIJ was reorganized as the current ICJ.

designated by that State, i.e., by the four jurists who can be called upon to serve as members of an arbitral tribunal under the Hague Conventions of 1899 and 1907.[410] In the case of countries not represented on the Permanent Court of Arbitration, nominations are made by a group constituted in the same way.[411]

For tax arbitration to work effectively, some appointing authority[412] also must be designated to address disagreements associated with the constitution of the tribunal. When a party fails to make a nomination within a specified period, or if the party nominees are unable to select a presiding arbitrator, it may be more desirable to entrust the selection to the appointing authority. The OECD suggested the use of OECD Center for Tax Policy and Administration ("CTPA") as the appointing authority in the OECD Sample Agreement. At this time, OECD seems to be the most qualifying institution as an appointing authority because OECD is the first institution to endorse a mandatory arbitration for international tax dispute resolution and its organ, the CTPA, is an agency that is specialized in tax within the OECD.[413] In establishing its list of potential

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[410] Statute of the International Court of Justice, Art. 4(1).

[411] http://www.icj-cij.org/court/index.php?p1=1&p2=2 (last visited Feb. 5, 2012).

[412] Not mentioned above as a potential appointing authority is the London Court of International Arbitration. The LCIA started as a tribunal for the arbitration of domestic and, in particular, of trans-national commercial disputes arising within the ambit of the city in 1892. It was initially named as The City of London Chamber of Arbitration. In 1903, the tribunal was re-named as the London Court of Arbitration. In 1981, the name of the Court was changed to The London Court of International Arbitration, to reflect the nature of its work, which was, by that time, predominantly international. The LCIA is one of the bigger permanent international arbitration institutions today and it promulgates its own arbitration rules and procedures, which are frequently adopted in ad hoc arbitrations even where the LCIA itself is not involved.

[413] This is the way the arbitrators are selected under the U.S.-Germany 2006 Protocol as well. Only difference is that the OECD prescribes the Director of the CTPA to appoint the chair while the U.S.-Germany 2006 Protocol, *supra* note 334, prescribes the highest-ranking member of the Secretariat at the CTPA to do the same. It seems that the U.S. and Germany 2006 Protocol wanted to seek the authority of a chairperson by ensuring that the appointment comes from the most authoritative person within the CTPA.

arbitrators, the appointing authority should consult with other institutions, including those with access to tax expertise such as the International Fiscal Association.

3. Formation of Arbitral Board and Time Frame

i. OECD Approach

The OECD proposed two alternative ways for arbitration process, three member arbitration process in Paragraph 5 and streamlined arbitration process in Paragraph 6 of the Sample Agreement. Each is explained below.

Three Member Arbitration Board

The sample arbitration agreement recommended by the OECD Commentaries envisage a classic three member tribunal where each of the two sides select an arbitrator, with the third arbitrator, selected by those first two arbitrators or the OECD CTPA, to act as the chairperson.[414] Formation of the three member arbitration tribunal suggested by the OECD Sample Agreement can be summarized as follows:

(1) Three (3) months, from the time arbitration request has been received by both competent authorities, for competent authorities to communicate and agree on the questions to be resolved (which will constitute the Terms of Reference);[415]

[414] 2008 OECD Sample Agreement, para 5.
[415] OECD Sample Agreement, *supra* note 323, para. 3.

(2) One (1) month for the taxpayer to send a tentative issues to be resolved if the competent authorities fail to communicate in step 1;[416]
(3) Three (3) months, from the time the Terms of Reference is received by the person who requested arbitration, for competent authorities to select an arbitrator of their choice;
(4) Ten (10) days for OECD CTPA to appoint arbitrators if competent authorities fail to appoint one in step 3;
(5) Two (2) months for the two selected arbitrators to appoint a chair person;
(6) Ten (10) days for OECD CTPA to appoint a chair person if the two selected arbitrators fail to appoint on in step 5;
(7) Six (6) months, from the time the Chair notifies the competent authorities that he has received all the information necessary, for arbitrators to decide the case (or issues) and deliver the decision to the competent authorities and the person who requested arbitration;[417]
(8) Two (2) months to wait if the arbitral tribunal made a request for additional information.

Under this classic three member panel arbitration, it would take more than 9 months just to form a tribunal from the time an arbitration request is made. It would likely take even longer considering the lead time for the parties for each step. Furthermore, even though the arbitration tribunal has 6 months to decide the case, the tribunal can request for additional information to further prolong

[416] *Id.*, para. 4.
[417] *Id.*, para. 16.

the process. Therefore, it seems that the entire process would take at least 14 months, and more likely longer than 18 months considering the necessary time for the rendering of the decision in each step of the process.

Streamlined Arbitration

The OECD Sample Agreement also suggests an alternative arbitration process in Paragraph 6 with the title of "Streamlined arbitration process." Under this streamlined arbitration process, only one arbitrator is selected by two competent authorities in common at the request of the taxpayer and the arbitrator's job is to choose one answer out of the answers submitted by each party.[418] Streamlined arbitration suggested by the OECD Sample Agreement would proceed as follows:

(1) Three (3) months, from the time arbitration request has been received by both competent authorities, for competent authorities to communicate and agree on the questions to be resolved (which will constitute the Terms of Reference);[419]
(2) One (1) month for the taxpayer to send a tentative issues to be resolved if the competent authorities fail to communicate in step 1;[420]
(3) One (1) month for competent authorities to appoint one arbitrator by common consent;
(4) Ten (10) days for the OECD CTPA to appoint one if the

[418] OECD Sample Agreement, *supra* note 323, para. 6.
[419] Id., para. 3.
[420] Id., para. 4.

competent authorities fail to agree in step 3;

(5) Two (2) months for competent authorities to submit their reply to the questions contained in the Terms of Reference;

(6) One (1) month for the sole arbitrator to decide the answer by choosing one of the two replies received from the competent authorities;

The main advantage of the streamlined arbitration is the shortened time until the decision is rendered as the streamlined arbitration can result in a decision in as short as 8 months. However, there is no deliberation by the arbitrator on the issues. The arbitrator simply chooses one of the resolutions submitted by the competent authorities as if it were a multiple choice question. Therefore, the benefit of shortened time for streamlined arbitration is arguably afforded at the expense of no deliberation of the issues presented but a simple choice by one arbitrator.[421]

ii. U.S.-Germany Income Tax Treaty

Given that the arbitration panel is required to adjudicate cases based on one of the proposed resolutions submitted by the Contracting States, the U.S.–Germany Income Tax Treaty envisioned a streamlined arbitration, which is the alternative provided for in Paragraph 6 of the OECD Sample Agreement. Only difference is that the U.S.-Germany Income Tax Treaty requires a three member

[421] Paragraph 13, *Id.*, is quite confusing. It says that "Paragraph 5 of the OECD Sample Agreement provides a streamlined process," but it is, in fact, Paragraph 6 that provides the streamlined process procedure—Paragraph 5 provides the classic three member arbitration. It is not clear whether there was a numbering error in the OECD Sample Agreement. The OECD specifically suggests the streamlined arbitration be used only for legal issues, which seems to imply that the streamlined process should not be used for cases in which factual determination is needed.

arbitration panel instead of one. [422] The following summarizes the time schedule of an arbitration under the U.S.-Germany Income Tax Treaty:

(1) Sixty (60) days to appoint an arbitrator of its choice from the date a written communication is sent to the other Contracting State (This is the date Proceeding begins)
(2) Sixty (60) days for two arbitrators chosen in step 1 above to choose a third arbitrator who would serve as Chair;
(3) Sixty (60) days for OECD CTPA to choose the remaining arbitrator(s) by notifying both Contracting States to the OECD if competent authorities fail to appoint arbitrator or the arbitrators chosen by the competent authorities fail to choose the third member;
(4) Ninety (90) days, from the time the Chair is appointed, for the Contracting States to submit a Proposed Resolution
(5) One hundred and eighty (180) days, from the time the Chair is appointed, for the Contracting States to submit Reply
(6) Six (6) months, from the time the Chair is appointed, for the arbitration board to deliver a determination by choosing one of the Proposed Resolutions.

Some of the steps overlap with each other and the minimum amount of time required for the completion of arbitration under the U.S.-Germany Protocol is 10 months. This time line is similar to the time line suggested by the streamlined arbitration under the OECD, but because the decision is made by

[422] 2006 Protocol, *supra* note 329, para. 22(h).

three arbitrators, even though it is a multiple choice decision, it is arguably fairer and more equitable.

iii. EU Transfer Pricing Arbitration Convention

The EU Transfer Pricing Arbitration Convention also aims to complete the entire arbitration within one year. An advisory commission is to be established no later than six months following the expiry of 2 year period for a MAP.[423] Then the advisory commission is required to deliver its opinion not more than six months from the date on which the matter was referred to it, i.e., 6 months from the time Chairperson confirms that its member have received all relevant documentation and information.[424] The total time it takes for an arbitration process under the EU Transfer Pricing Arbitration Convention is 2 to 3 months longer than what it takes under the U.S.-Germany Protocol. This 2 to 3 month time difference comes from the time it takes to form an arbitral panel as the EU Transfer Pricing Arbitration Convention provides 6 months to form a panel while the U.S.-Germany Protocol provides 3 months. For both conventions, the time provided for an arbitral decision to be rendered is the same, 6 months. However, there is a critical difference between the two that the EU Arbitration Convention give such 6 months to arbitrators and the arbitration decision needs to contain the arguments and reasons on which the decision in the opinion is based[425] while the same 6 month period is provided to the competent

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[423] EU Revised Code of Conduct, supra note 258, Para. 7.2.(b)..

[424] EU Transfer Pricing Arbitration Convention, supra note 255, Art. 11; EU Revised Code of Conduct, supra note 258, Art. 7.3.(a) of the Code of Conduct

[425] EU Revised Code of Conduct, *supra* note 258, Art. 7.4 (prescribing the details in terms of what is to be included in the opinion).

authorities under the U.S.-Germany Protocol to prepare model answers from which the arbitrators can choose.

iv. Format of Decision

As discussed above, the format of the decision, i.e., whether it is a reasoned decision or a choice out of the answers provided by the competent authorities, makes significant difference to the total time for an arbitration process to be completed. The three member classic arbitration process proposed by the OECD takes almost 2 years to complete during which more than 8 month period is devoted to arbitrators for deliberation of issues and delivery of a decision. On the other hand, the streamlined arbitration process offers faster resolution (less than a year) but sacrifices the substance of arbitration in that arbitrators do not deliberate on the issues as the decision is simply a choice, by one arbitrator, out of the answers provided by the competent authorities. The U.S.-Germany Protocol improves this streamlined arbitration by offering a panel of three arbitrators, but still the decision lacks reasons or analysis of the issues. The problem with the streamlined arbitration is that 6 month period is provided to competent authorities for submission of their answers to the issues. The fundamental reason for the taxpayer to initiate arbitration is because the two competent authorities are not able to reach a mutual agreement. The reason for failing to come to a mutual agreement is because the two competent authorities probably have irreconcilably different views on the issues. It does not make sense to provide 6 months to further elaborate their own views when it is clear that the two competent authorities already had occasions to share their irreconcilable difference during the MAP. Even if the decision comes out, it would be difficult for the competent authority, whose answer was not chosen, to

accept the decision, particularly when such decision is made by only one arbitrator.

The EU Transfer Pricing Arbitration Convention offers both fast resolution and reasoned decision. The critical difference is that the same 6 month time period is provided for the arbitrators to deliberate on the issues. Arbitrators required to explain themselves must think more about the basis for their decisions and it would be easier for the competent authorities and the affected taxpayers to accept the decision because the decision contains reasons and methods.[426] Accordingly, the three member classic arbitration process proposed by the OECD can be improved, without sacrificing the time needed for arbitrators to deliberate the issues, by adopting the efficient features of the arbitration process of the EU Transfer Pricing Arbitration Convention.

v. Suggested Changes to Timeline by the OECD

It was discussed that it can take longer than 9 months just to form an arbitration board and at least 14 months--more likely over 18 months--to render a decision under the classic three member arbitration process proposed by the OECD Sample Agreement. The OECD's proposed time frame is generous and provides a lot of leeway. For example, time starts ticking when the arbitration panel sends a notification of the receipt of all information to all concerned parties, and there can be a gap between the time the information is actually received and the time when the Chair actually "writes" and "sends" the acknowledgement of the

[426] This reasoned decision is consistent with the practice of international commercial arbitrations as all major institutional rules for international commercial arbitration, such as ICC, LCIA, UNCITRAL, and ICSID, require arbitrators to state the grounds for their decision.

receipt. Neither the EU Transfer Pricing Arbitration Convention nor the U.S.—Germany Protocol refers to extension of time for reviewing and delivering a decision, but the OECD allows an additional 6 months for deliberation of a decision. The whole purpose of arbitration is to wrap up the dispute that has been going on for two years. Taking another two years for the procedure would defeat the purpose of arbitration, i.e. to put an end to a long-lasting dispute. Suggested below is an example of improved timeline created based on the method adopted by the U.S.-Germany Tax Treaty and the EU Transfer Pricing Arbitration Convention:

(1) Unless the competent authorities of both contracting states and the concerned persons agree otherwise, the Arbitral Tribunal shall be composed of three members. Within three months after second competent authority is in receipt of a notice of arbitration from the first competent authority, the competent authorities shall each appoint one arbitrator.
(2) Within one month of the appointment, the arbitrators so appointed shall appoint a third arbitrator who will function as the Chair.
(3) If any appointment is not made within the required time period, the arbitrator(s) not yet appointed shall 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 one of the competent authorities or the person who made the request for MAP.
(4) The same procedure shall apply with the necessary adjustments if, for any reason, it is necessary to replace an arbitrator after the arbitral process has begun.
(5) The arbitration board will deliver a determination in writing to the

Contracting States within six months of the appointment of its Chair.

(6) The competent authority will implement the arbitration decision within 3 months from the receipt of the decision.

The timeline suggested above gives about 5 months (including about a month to inform the initiation of arbitration to the other competent authority) to form an arbitration board and 6 months for the arbitration board to decide the case,[427] therefore, a total of 11 months to have a case resolved without sacrificing the time that arbitrators need to analyze and deliberate on the issues. Furthermore, it provides certainty to the affected taxpayer that the taxpayer actually can request for a refund three months after the decision.

C. Arbitration Process

1. Confidentiality

i. Level of Confidentiality

The Sample Arbitration Agreement recommended by the OECD Commentary suggests that each arbitrator shall be designated as an authorized representative of the competent authority concerning the confidentiality of information.[428] The explanations to the Sample Agreement further state that arbitrators are subject to the same confidentiality requirements that are applicable to the competent

[427] See *infra* Ch. 4. Part III. Sec. C.5 for discussion of suggested timeline for delivering an arbitral decision.

[428] OECD Sample Agreement, *supra* note 323, para. 8.

authorities.[429] Regarding the competent authority's confidentiality obligation, Article 26 of the OECD Model Tax Convention states that "any information received shall be treated as secret in the same manner as information obtained under the domestic laws of that State." [430] It also states that the information shall be disclosed to persons or authorities related to tax or "oversight" bodies and that such persons or authorities may disclose information in public court proceedings or in judicial decisions. Thus, the confidentiality obligation imposed on arbitrators is regulated by the domestic rules, which generally have many exceptions and caveats that allow them to eventually disclose information. Furthermore, the sample Arbitration Agreement of the OECD Model Tax Convention is silent on what happens upon a breach of the confidentiality obligation.

This is problematic for several reasons. First of all, there is no separate provision for confidentiality in the Convention; confidentiality is addressed only as a part of the provisions dealing with Exchange of Information. Exchange of information naturally entails disclosure of information, and confidentiality could only come next. These two principles go together as one protects the other, but they are also inherently incompatible with each other. Secondly, information received can be disclosed to "oversight" bodies, including authorities that supervise tax administration and enforcement authorities. In Korea, such "oversight" bodies would include the Ministry of Strategy [431] and Finance or the Board of Audit and Inspection [432]. The

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[429] *Id.*, at para. 17.
[430] 2010 OECD Model Tax Convention, *supra* note 116, Art. 26(2).
[431] The National Tax Service, the tax administration agency in Korea, is an affiliate organization of the Ministry of Strategy and Finance.

Commentary merely states that oversight bodies include supervisory authorities, yet fails to limit the scope. So, if other authorities are involved as part of general administration of the Government, it is possible that information may end up in the hands of those other authorities. Thirdly, information may be disclosed in court proceedings or judicial decisions. The Commentary states that the information provided in public court proceedings becomes public information and such information can be quoted from the court files or for other decisions.[433] Lastly, the domestic laws of the receiving State would govern the confidentiality, e.g., Korean law governs the treatment of the information received by a Korean competent authority.[434] Considering that, when multiple countries are involved in a case, each of such countries would apply different rules concerning confidentiality, such disparity in law could create a loophole in maintaining the confidentiality. Also, domestic confidentiality laws generally have many exceptions and caveats that would allow the government to disclose information. Taxpayers may feel uneasy about different exceptions and caveats in the contracting countries.

As discussed above in Chapter 3, Part III.C.3, the EU Transfer Pricing Arbitration Convention requires arbitrators to keep secret all matters that they learn of as a result of the proceedings, and a breach of this confidentiality obligation can result in a punitive action and reporting to the EU Council.[435] The EU Transfer Pricing Arbitration Convention's guidelines and related

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[432] The Board of Audit and Inspection is authorized to inspect the works performed by government agencies and the duties of their employees.
[433] 2010 OECD Model Tax Convention, *supra* note 116, Commentary to Art. 26. Para. 13.
[434] *Id.*, para. 11.
[435] *See supra* Ch. 3, Part II. Sec. E.

penalty are specific and clear. As such, if the OECD were to provide guidance as well, it would be desirable to make the guidelines specific and clear.

2006 Protocol to the U.S.-Germany Income Tax Treaty is also clear about the confidentiality as it explicitly requires each concerned person and their authorized representatives or agents to agree, prior to the beginning of arbitration proceedings, not to disclose to any other person any information received from either competent authority or the arbitration board during the course of the arbitration proceedings.[436] Arbitrators are also required to sign a confidentiality statement. Furthermore, the required level of confidentiality is stricter than that required under the OECD Model Tax Convention. In comparison to the OECD Model Tax Convention which allows disclosure so long as it is "foreseeably relevant," the U.S.—Germany Income Tax Treaty allows disclosure of information only when it is "necessary." Unlike the OECD Model Tax Convention, the U.S.—Germany Income Tax Treaty does not include "oversight" bodies to whom the information can be disclosed. Also, the competent authority of the government supplying the information has a right to raise an objection when such information is set to be disclosed for public proceedings or judicial decisions.[437] As a result, the U.S – Germany Income

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[436] 2006 Protocol, *supra* note 329, para. 22(d).

[437] Article 26 (Exchange of Information and Administrative Assistance), Paragraph 1 of the U.S.-Germany Income Tax Treaty provides "[t]he competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Convention and of the domestic law of the Contracting States concerning taxes covered by this Convention insofar as the taxation thereunder is not contrary to this Convention . . . . Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment, collection, or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes covered by this Convention. Such persons or authorities shall use the information only for such purposes. They may disclose the information

Tax Treaty provides a stronger confidentiality protection because (i) the parties would be more careful in disseminating information when they physically execute confidentiality agreements; (ii) only "necessary" information would be subject to the Exchange of Information provision; and (iii) there is a mechanism built into the confidentiality clause to protect the information from becoming public. Importantly, arbitration itself cannot even start in the first place unless preceded by receipt of the nondisclosure agreements by both competent authorities.[438]

ii. Non-Transparency

Confidentiality means non-transparency. Non-transparency has been pointed out as one of the weaknesses of the MAP, though it has also been cited as an advantage. It seems that the majority of commentators believe that confidentiality is an essential feature in arbitration.[439] In commercial arbitrations, confidentiality has traditionally been one of the important advantages, although it is weakening more or less in cases involving public interest.[440]

On the flip side, at least one commentator believes otherwise.[441] Notwithstanding the OECD's seemingly advocating transparency, McIntyre

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in public court proceedings or in judicial decisions, unless the competent authority of the Contracting State supplying the information raises an objection."

[438] 2008 MOU, *supra* note 329, para. 5(a)(ii).

[439] Altman, *supra* note 4, at 423; Burnett, *supra* note 159, note 28, at.185; Park, *supra* note 13, at 819-20. Also, OECD Commentaries and 2006 Protocol, *supra* note 329, agreed by the U.S. and Germany have a provision on confidentiality.

[440] Redfern, *supra* note 243, at 136, 140.

[441] McIntyre, *supra* note 398, note 61, at 631. McIntyre devoted the entire chapter on the discussion of secrecy and criticized the OECD for endorsing opaqueness.

rather strongly criticized that the OECD has been endorsing opaqueness. He asserts that OECD, by endorsing opaqueness, undermines its credibility, which undercuts the value in guidance on related cases and creates substantial risk of fraud. He further argues that transparency can be achieved in arbitration by referencing to the WTO arbitration model.

Notwithstanding the foregoing criticism, given that the arbitration model suggested by the OECD is part of the MAP which rarely involves public interest, it is not sensible to make the arbitration proceeding public when the MAP itself is confidential. Also, it seems premature to discuss the transparency of the arbitration process at a time when neither the competent authorities nor the taxpayers would agree to such non-confidentiality. Rather, this is a topic to be developed further in the future after arbitration is settled and accepted by the international community as an avenue for dispute resolution on international tax matters.

iii. Sub-Conclusion

The current OECD Sample Agreement (and the OECD Model Tax Convention) does not seem to provide clear guidance on confidentiality. It also fails to provide sufficient confidentiality protection for taxpayers as the relevant provision simply designates the state-appointed arbitrator as the authorized representative of that state, and fails to clearly delineate the permitted scope of representation.

Confidentiality should be afforded to all parties to tax treaty arbitration, at least until tax treaty arbitration becomes more accepted and settled as a method of

resolving international tax disputes. To this end, the EU Transfer Pricing Arbitration Convention is a good example of how the confidentiality provisions can reinforce protection for taxpayers and place more responsibility on competent authorities, arbitrators and all other parties involved. The U.S.—Germany Income Tax Treaty may not afford as comprehensive of protection as in the EU Transfer Pricing Arbitration Convention, but is certainly an improvement from the OECD version because it is binding on all concerned persons within the context of Article 26 of the Exchange of Information provision. It would be desirable to include a specific provision on non-disclosure obligation of all involved persons as follows:

OECD SAMPLE AGREEMENT	SUGGESTED CHANGES
8. Communication of information and confidentiality *For the sole purposes of the application of the provisions of Articles 25 and 26, and of the domestic laws of the Contracting States, concerning the communication and the confidentiality of the information related to the case that results in the arbitration process, each arbitrator shall be designated as authorized representative of the competent authority that has appointed that*	*Communication of information and confidentiality* (a) The concerned person(s), and their authorized representatives or agents, must agree prior to the beginning of arbitration proceedings not to disclose to any other person any information received during the course of the arbitration proceeding from either Contracting State or the arbitration board, other than the determination of such board subject to sub-paragraph (b)

arbitrator or, if that arbitrator has not been appointed exclusively by one competent authority, of the competent authority of the Contracting State to which the case giving rise to the arbitration was initially presented. For the purposes of this agreement, where a case giving rise to arbitration was initially presented simultaneously to both competent authorities, "the competent authority of the Contracting State to which the case giving rise to the arbitration was initially presented" means the competent authority referred to in paragraph 1 of Article 25.	below; (b) For purposes of an arbitration proceeding under paragraph 5 and this paragraph, the members of the arbitration board and their staffs shall be considered "persons or authorities" to whom information may be disclosed under Article 26 (Exchange of Information and Administrative Assistance) of the Convention."

2. Logistical Arrangements and Venue

The OECD Sample Agreement lays out that the competent authority to which arbitration was first presented shall bear the responsibility of arranging the meetings of the arbitral panel and providing the administrative personnel necessary for the conduct of arbitration. The administrative person is to report only to the chair of the arbitration panel.[442] However, the competent authorities are free to determine whatever suits their needs.

[442] *Id.*, para. 12.

The OECD approach is consistent with the EU Transfer Pricing Arbitration Convention and the U.S-Germany Tax Treaty with minor differences. Specifically, under the EU Transfer Pricing Arbitration Convention, the responsibility for logistical arrangement is imposed on the State that initiated the establishment of the advisory commission unless otherwise agreed by the concerned States.[443] Practically, that would be the State that the arbitration was first presented to. The administrative assistant (called "Secretariat") will report to the Chairman and is also bound by the secrecy provision of the EU Transfer Pricing Arbitration Convention.[444]

The U.S.—Germany Tax Treaty also specifies that meeting facilities, financial management, other logistical support and general administrative coordination of the proceedings will be provided by the Contracting State whose competent authority initiated the MAP in the case.[445]

All three conventions mentioned above presume that logistical arrangements are to be handled by the competent authority to which the case was initially presented.[446] The reason for such presumption comes from the expectation that the competent authority will use meeting facilities and personnel that it already has at its disposal, i.e., the arbitration meetings will take place in the country in

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[443] EU Revised Code of Conduct, *supra* note 258, Art. 7.2(d).
[444] *Id.*
[445] 2006 Protocol, *supra* note 329, para. 22(o). Under the U.S.—Germany Tax Treaty, a taxpayer is not required to apply for arbitration, but arbitration is automatically offered at the end of the two-year-period from the date the MAP started. Therefore, it makes sense that the State which initiated the MAP is the State that initiates arbitration since the concerned taxpayer who requested the MAP initially is likely to have requested arbitration.
[446] OECD Sample Agreement, *supra* note 323, Explanations, para. 21.

which the case was initially brought.[447] This is different from commercial arbitration in which the location of arbitration is one of the most important aspects of arbitration for the purpose of later recognition and enforcement of arbitral decision.[448] However, the situation is different in tax arbitrations. The countries are also parties to the dispute, and they create the arbitration's legal framework. Thus, the arbitral decision would not normally be presented for enforcement in a country that is not a party to the arbitration.

Even though the OECD seems to have envisioned that arbitration meetings would take place in the country in which the case was initially brought, it does not specify the venue but it leaves these administrative matters to be agreed by the competent authorities. Again, it is better to specify in the agreement by adding a paragraph that "the venue of arbitration will be the country of the competent authority which is responsible for the logistical arrangements unless agreed otherwise by the competent authorities" so that unnecessary time to work out logistical arrangements and choice of venue is wasted.

OECD SAMPLE AGREEMENT	SUGGESTED CHANGES

[447] OECD Sample Agreement, *supra* note 323, Explanations, para. 22.

[448] In commercial proceedings, the place of arbitration can have significant consequences. Almost all arbitration proceedings will have an official "seat" (at which the award will usually be deemed to have been made), selected either directly by the parties or through delegation to an arbitral institution. Under the U.N Model Arbitration Law, domestic court can refuse to recognize or enforce the arbitral decision that is either (i) not valid under the laws of the country where the decision was rendered; or (ii) suspended by a court of the country in which the award is made. UN, Comm'n on Int'l Trade Law, *Model Arbitration Law*, art. 36(1)(a)(i) and (v) [hereinafter UN Model Arbitration Law].Consequently, of importance are: (i) the location of commercial arbitrations; and (ii) a neutral third country with a clean track record in terms of intrusive judicial review that would weaken the legitimacy of the arbitration board's decision. Redfern, *supra* note 243, at 186-193.

12. Logistical arrangements *Unless agreed otherwise by the competent authorities, the competent authority to which the case giving rise to the arbitration was initially presented will be responsible for the logistical arrangements for the meetings of the arbitral panel and will provide the administrative personnel necessary for the conduct of the arbitration process. The administrative personnel so provided will report only to the Chair of the arbitration panel concerning any matter related to that process.*	*Logistical arrangements and Venue* Unless agreed otherwise by the competent authorities, the competent authority to which the case giving rise to the arbitration was initially presented will be responsible for the logistical arrangements for the meetings of the arbitral panel and will provide the administrative personnel necessary for the conduct of the arbitration process. The administrative personnel so provided will report only to the Chair of the arbitration panel concerning any matter related to that process. Also, unless agreed otherwise by the competent authorities, the venue of arbitration will be the country of the competent authority which is responsible for the logistical arrangements.

3. Costs of Arbitration Panel

OECD's principle on cost allocation is that costs that can be controlled by each party are to be borne by each party while other costs are to be born equally by

the two competent authorities.[449] Therefore, the cost for travel and preparation of documents, for example, would be borne by each party. Each competent authority is also to pay for the cost of the arbitrator it appoints. The cost for the presiding arbitrator would be shared equally by the two competent authorities. This is different from the approach taken by the EU Transfer Pricing Arbitration Convention and the U.S.-Germany Income Tax Treaty, under which fees and expenses relating to the arbitration panel will be shared equally by the two competent authorities.[450]

The OECD does not provide guidance as to the level of fees for arbitrators. The U.S.-Germany Income Tax Treaty provides for USD 2,000 per day for fees for arbitrators and the expenses of the arbitrators in accordance with the ICSID Schedule of Fees for arbitrators.[451] Under the EU Transfer Pricing Arbitration Convention, compensation of arbitrators is fixed at EUR 1,000 per person per meeting day and the Chairman will receive a fee 10% higher than that of the other arbitrators.[452] Adequate remuneration is important for attracting qualified arbitrators in the long-run. However, for some reason, the fees for arbitrators under both the EU Transfer Pricing Arbitration Convention and the U.S.-Germany Income Tax Treaty are lower than what is prescribed by the ICC and the ICSID. For arbitrator fees, the ICC sets a sliding scale fee system which starts at USD 3,000 for disputes under USD 50,000,[453] and increases as the

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[449] OECD Sample Agreement, *supra* note 323, Explanations, para. 26.
[450] EU Revised Code of Conduct, *supra* note 258, Arts. 7.3(e)-(f).
[451] 2006 Protocol, *supra* note 329, para. 22(o).
[452] EU Revised Code of Conduct, *supra* note 258, Art. 7.3(f)(ii).
[453] See ICC Rules of Arbitration, International Chamber of Commerce (ICC) 1/1/20082008, Appendix II, Art. 2. Costs and Fees, Appendix II, Art. 2. Costs and Fees.

dispute amount increases.[454] The ICSID rules also specify USD 3,000 per day, but without a sliding scale.[455,456] There is no definite reason or explanation for the lower fees, but it is possible that both treaties gave consideration to the fact that, unlike commercial arbitrations which involve disputes over large amounts of money between private parties, tax treaty arbitration involves two governments, and that the dispute generally is a matter of revenue sharing. No specific recommendation is made for the costs in this paper as it is a subject matter that the two governments need to agree specifically because the reasonable level of costs can differ depending on the countries involved.

4. Applicable Legal Principles

The OECD suggests that the following legal principles may apply to arbitration proceedings and does not mention any order of priority:

1) Applicable provisions of the treaty itself;
2) Domestic laws of the Contracting States;
3) Article 31 to 33 of the Vienna Convention on the Law of Treaties

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[454] Based on the ICC's Costs and Fees schedule, the arbitrator fee can exceed USD 200,000 depending on the amount of the dispute.

[455] Int'l Ctr. For Settlement of Investment Disputes, Schedule of Fees, https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=scheduledFees&reqFrom=Main.

[456] For comparison purposes, ICSID Schedule of Fees and ICC Fees are introduced below:

	ICSID	ICC
Arbitrator Fees	USD3,000 per day	USD3,000 and up
Direct Expenses	Reimbursable	Reimbursable
Administrative Fee	USD32,000	USD3,000 and up[456]
Filing Fee	USD25,000	USD3,000
Appointment of Arbitrator	USD10,000	Service fee up to USD10,000 including the filing fee

for interpretation cases;

4) Commentaries of the OECD Model Tax Convention;
5) OECD Transfer Pricing Guideline for Multinational Enterprises and Tax Administrations;
6) Any other sources that the competent authorities expressly identify.

The U.S.-Germany Income Tax Treaty specifies the following legal principles to be applied in a descending order of priority:

1) Provisions of the Convention;
2) Any agreed commentaries or explanations of the Contracting States concerning the Convention;
3) The laws of the Contracting States to the extent they are not inconsistent with each other; and
4) Any OECD Commentary, Guidelines or Reports regarding relevant analogous portions of the OECD Model Tax Convention.

The task of the arbitrators will be to interpret the applicable treaty. In some cases, the treaty will expressly direct application of domestic law. The OECD seems to have recognized this and the domestic laws apply as a second priority.[457] In other cases, treaty definitions will be independent of the law of either Contracting State. In such instances, the arbitrators would attempt to determine the intent of the two treaty partners, looking to interpretative aids such as commentaries (but not unilateral "explanations") and the Vienna Convention.[458] This seems to be the reason that the U.S. and Germany agreed

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[457] OECD Sample Agreement, *supra* note 323, Explanations, para. 34.

[458] *See* Vienna Convention on the Law of Treaties, Art. 33(4), signed on May 23, 1969, 1155 U.N.T.S. 331, 340 (providing for the adoption of the "meaning which best reconciles the texts,

to not only apply commentaries or explanations of the treaty as a second priority, but also have both parties agree on such commentaries or explanations so that the unilateral explanations do not come into play as authoritative rules. The OECD also designated the Vienna Convention on the Law of Treaties as the third source of the applicable laws because the Vienna Convention permits a wide access to supplementary means of interpretation; as a result, arbitrators can have considerable latitude in determining relevant sources for the interpretation of treaty provisions. [459] It would be premature to decide whether or not such wide access to supplementary materials is beneficial. However, considering that excessive amount of information in hand may sometimes delay the decision making process, it may be desirable to limit the type of supplementary materials for now. The governments are free to agree on the applicable laws and legal principles, but the most relevant law is probably the treaty itself, out of which the case or issue arises. For the interpretation of the treaty, governments differ in what should apply first, but probably commentaries or explanation of the domestic country would be in understanding how treaties are interpreted in the domestic countries. Domestic laws are also important because it is always the domestic law that authorizes the tax assessments that led to arbitration. The OECD Commentaries or Guidelines come next as helpful source for knowing how the international institution deals with certain tax issues.

1) the provisions of the Convention;
2) any agreed commentaries or explanations of the Contracting States concerning the Convention;

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having regard to the object and purpose of the treaty"). Art. 31-33 regarding interpretation of treaties is introduced as Appendix VI at the end of this paper.

[459] OECD Sample Agreement, *supra* note 323, Explanations, para. 33.

3) the laws of the Contracting States to the extent they are not inconsistent with each other; and
4) any OECD Commentary, Guidelines or Reports regarding relevant analogous portions of the OECD Model Tax Convention

OECD SAMPLE AGREEMENT	SUGGESTED CHANGES
14. Applicable Legal Principles *The arbitrators shall decide the issues submitted to arbitration in accordance with the applicable provisions of the treaty and, subject to these provisions, of those of the domestic laws of the Contracting States. Issues of treaty interpretation will be decided by the arbitrators in the light of the principles of interpretation incorporated in Articles 31 to 33 of the Vienna Convention on the Law of Treaties, having regard to the Commentaries of the OECD Model Tax Convention as periodically amended, as explained in paragraphs 28 to 36.1 of the Introduction to the OECD Model Tax Convention. Issues related to the application of the arm's length principle should similarly be decided having regard to the*	*Applicable Legal Principles* In making its determination, the arbitration board will apply, as necessary and in descending order of priority: (a) the provisions of the Convention; (b) any agreed commentaries or explanations of the Contracting States concerning the Convention; (c) the laws of the Contracting States to the extent they are not inconsistent with each other; and (d) any OECD Commentary, Guidelines or Reports regarding relevant analogous portions of the OECD Model Tax Convention

OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. The arbitrators will also consider any other sources which the competent authorities may expressly identify in the Terms of Reference.	

There may be cases in which the laws of the two Contracting States provide conflicting characterizations. For example, one country may characterize fees to an engineering firm as fees for services, which are treated as business profit being exempt from tax in a source country unless there is a permanent establishment in the source country, while the other country may consider the same to be fees for remuneration for the use of intangible property or know-how, i.e., royalty income being subject to withholding tax in the source country. Another area that potentially poses difficulty in finding applicable law is the "arm's length price" issue. Most treaties include language that permits allocation of income and deductions among related parties. However, each country may define the standard of allocation differently. For example, the U.S. applies the "commensurate with the income" standard[460] while some countries apply "as if the parties were independent third parties" standard. An arbitral tribunal may be faced with a dilemma in deciding what standard to apply and what the definition of such standard is. In any case, arbitrators should be

[460] *I.R.C. § 482* (2002); *see also Treas. Reg. § 1.482-4* (2002).

encouraged to make a principled decision focusing on the legal merits of the case.[461]

5. Formality of the Decision[462]

It was discussed above in Part III.B.3. that it does not need to sacrifice the time for arbitrators to deliberate the issues in order to speed up the arbitration process and showed that the time provided to competent authorities under a streamlined arbitration process is equivalent to the time provided to arbitrators under a classic arbitration process.

However, at least one commentator argues otherwise because downside to reasoned awards is that they provide the losing party bases for challenging the award.[463] In fact, there can be some cases that may be suitable for the "check the box" approach, or streamlined approach as termed by the OECD, which resembles the approach taken by the U.S.-Germany Income Tax Treaty under which no rationale is to be stated for the decision made by arbitrators, but an

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[461] Park, *supra* note 13, at 836. Park warns that "commonly accepted standards," which require the arbitrators to seek principled solutions that go beyond their own particular views of justice, should not to be confused with amiable composition, an approach taken in some international proceedings that permits arbitrators to decide not by reference to any substantive legal system, but according to what they consider fair and appropriate under the context.

[462] The Sample Agreement contributes 4 paragraphs to a decision by the arbitral tribunal; Paragraph 15 on arbitration decision in general; Paragraph 16 on time allowed for communicating the arbitration decision; Paragraph 17 on a failure to communicate the decision within the required period; and Paragraph 18 on a final decision. It seems unconvincing that this topic deserves four paragraphs, but all four paragraphs are grouped together for the purpose of this paper.

[463] ROBERT COULSON, BUSINESS ARBITRATION 30 (4th ed. 1991) ("Written opinions can be dangerous because they identify targets for the losing party to attack."); see also Q&A, 48 DISP. RESOL. J. 63 (1993) ("One reason for the lack of explanation in arbitration decisions is to avoid the opening of avenues for attacking the award.").

arbitration board simply chooses (i.e., checks the box on) one of the parties' final ("last best") offers or proposed resolutions as the decision.[464] This procedure encourages both sides to move toward the middle ground because a party that submits unreasonable figures risks rejection of its position, leaving the other side's submission as the only alternative, particularly in transfer pricing cases.[465]

Nonetheless, reasoned decisions are better accepted by arbitration parties and showing how the decision was reached is important in assuring acceptance of the decision by all relevant participants.[466] Businesses or governments do not feel comfortable about the "check the box" approach, which is the 'streamlined arbitration process' in the Sample Agreement proposed by the OECD, when a large amount of money is at stake. In many continental European legal systems, reasoned opinions are mandatory on the theory that they discourage arbitrators from making biased or irrational decisions.[467] The OECD also requires arbitral decisions to be presented in writing with the sources of the law relied upon and the underlying reasoning when a classic three member arbitration process is to

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[464] 2006 Protocol, *supra* note 329, para. 22(h). This is also often called "baseball arbitration" because of its use in setting compensation of major league American ballplayers. Each year in the United States in late February or early March, American newspapers publish lists of baseball players who ask to have their salaries decided by arbitration, along with offers by the teams and demands by the players. In the vast majority of cases, players and teams settle for something between the two opening figures.

[465] It is difficult to comprehend the OECD's intention when the OECD stated that the streamlined arbitration is more suitable for cases to which the appropriate legal principle is applied. *See* OECD Sample Agreement, *supra* note 323, Explanations, para. 13, at 130. Within the same paragraph, the OECD claims that a streamlined arbitration may be a good tool to resolve transfer pricing cases, which are factual cases. This paragraph is confusing and need to be reviewed by the OECD.

[466] OECD Sample Agreement, *supra* note 323, Explanations, para. 36.

[467] Park, *supra* note 13, at 823.

be used, which would make the arbitrators' job more difficult, but the end product would be better decisions.

Format of Decision

Even though the OECD contemplates a reasoned decision, it does not provide guidance on what needs to be included in the decision. The EU Transfer Pricing Arbitration Convention provides guidance in this respect by requiring that a decision include the following items:[468]

(a) The names of the members of the advisory commission;[469]
(b) The request, containing:
    i. The names and addresses of the enterprises involved;
    ii. The competent authorities involved;
    iii. A description of the facts and circumstances of the dispute;
    iv. A clear statement of what is claimed;
(c) A short summary of the proceedings;
(d) The arguments and methods on which the decision in the opinion is based;
(e) The opinion;
(f) The place where the opinion is delivered;
(g) The date on which the opinion is delivered;
(h) The signatures of the members of the advisory commission.

OECD SAMPLE AGREEMENT	SUGGESTED CHANGES

[468] EU Revised Code of Conduct, *supra* note 258, Art. 7.4 .
[469] The EU Transfer Pricing Arbitration Convention labeled the arbitration tribunal as advisory commission and the arbitration decision to be an opinion.

15. Arbitration decision *Where more than one arbitrator has been appointed, the arbitration decision will be determined by a simple majority of the arbitrators. Unless otherwise provided in the Terms of Reference, the decision of the arbitral panel will be presented in writing and shall indicate the sources of law relied upon and the reasoning which led to its result. With the permission of the person who made the request for arbitration and both competent authorities, the decision of the arbitral panel will be made public in redacted form without mentioning the names of the parties involved or any details that might disclose their identity and with the understanding that the decision has no formal precedential value.*	*Arbitration Decision* (a) Where more than one arbitrator has been appointed, the arbitration decision will be determined by a simple majority of the arbitrators. (b) The decision of the arbitral panel will be presented in writing within six months of the appointment of its Chair and shall include the following items: (i) nature of the request with the following information: · name and address of the taxpayer; · the competent authorities involved; · description of the facts and circumstances of the dispute; · a clear statement of what is claimed; (ii) a short summary of the proceedings; (iii) the sources of law relied upon and the reasoning which led to its result

	opinion; (iv) the place and date of the decision; (v) the signatures of the arbitrators

D. Recognition and Enforcement of the Award

Recognition and enforcement are two distinct terms. An award may be recognized without being enforced. However, if it is to be enforced, then it must necessarily be recognized first. Recognition on its own is generally a defensive process, and the court is asked to recognize the legal force and effect of the award. Enforcement goes a step further in that it ensures the award is carried out.[470]

1. Sovereign Immunity or State of the Act Doctrine

In many countries, both the Act of State doctrine and sovereign immunity doctrine may be invoked against arbitral decisions that involve governments or direct governmental acts because a sovereign State cannot be compelled to submit to the jurisdiction of another State. Sovereign immunity exists in two

[470] Redfern, *supra* note 243, at 621-79. The use of recognition on its own may be illustrated by taking the example of a company that is made a defendant in legal proceedings by a foreign supplier for goods sold and delivered but allegedly not paid for. Suppose that the dispute between the company and the foreign supplier has already been submitted to arbitration, and that an award has been made, in which the foreign supplier's claim was dismissed. If the foreign supplier brings a new claim, then the company would ask the court to recognize the award as a valid defense to such new claim by the foreign supplier.

forms: (i) jurisdictional immunity that the sovereign immunity or the Act of State doctrine would prevent the States from being parties to tax treaty arbitrations, and (ii) immunity from execution that the states can be compelled to recognize and enforce arbitral decisions.[471]

However, the Contracting States can waive their jurisdictional immunity by agreeing to arbitrate before the arbitral tribunal. By the same logic, neither doctrine should impede the enforcement of arbitral decisions. It is a well-established principle of international law that a sovereign is bound by an agreement to arbitrate, and that sovereign immunity does not prevent a State or State agency from agreeing to submit to the authority of an arbitral tribunal.[472] Both arbitration and the enforcement of arbitral decisions can be, and should be, addressed in the income tax treaties and/or arbitration agreements within the constitutional limits of each contracting state. Explicit tax treaty language should be drafted to address the concern that the Act of State doctrine or sovereign immunity would pose a problem to tax arbitration and to have the States waive the doctrines.[473] Accordingly, it is suggested that a separate paragraph be added to Article 25 to the effect that an arbitration decision shall not be denied of recognition by reason of the act of state doctrine or sovereign immunity doctrine.[474]

2. From the Perspectives of International Law

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[471] *Id.*, at 666-72.
[472] *Id.*, at 666.
[473] WILLIAM W. PARK & DAVID R. TILLINGHAST, INCOME TAX TREATY ARBITRATION 66 (2004). It is suggested in Chapter 5 that sovereign immunity should not be a defense in a suit seeking recognition of arbitral decision in the context of Korea.
[474] See generally *infra* Ch. 5, in particular, Part III.E.

International treaties are agreements between States, and States basically rely on mutual voluntary compliance with treaties. It works in the same way for the MAP, which is basically an informal negotiation between tax authorities, which are government agencies of the Contracting States.[475] The honoring of the MAP results comes from the fact that the MAP and its result are negotiated by the two competent authorities themselves (i.e., the governments themselves). Tax arbitration, being an extension of the MAP, is likely to have the same implication. Although it may be reasonable to expect that, in most cases, Contracting States will honor arbitral decisions, this is not guaranteed due to the nature of voluntary compliance. It is possible that some may simply decline to enforce an arbitral decision adverse to their interests. Given that international law lacks the authority to enforce the award, such decline may give rise to just another international dispute that would require peaceful settlement.[476] In such case, the difficulty is that a party to such new dispute has already refused to carry out the decision, and is not likely to respect another decision that would, at the most, merely state that the government must comply.

In 2001, the UN International Law Commission issued and adopted a draft of Responsibility of States for Internationally Wrongful Acts ("ILC Draft"), submitted to the General Assembly.[477] Article 12 of the ILC Draft specifically

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[475] *See generally supra* Ch. 2 for comprehensive discussion on the MAP.

[476] Züger, *supra* note 158, at 48 n.169, quoting from "Appeal and Judicial Review in International Arbitration and Adjudication: The Case of the WTO Appellate Review" by Giorgio Sacerdoti, International Trade Law and the GATT/WTO Dispute Settlement System 1997, at 248.

[477] The topic of state responsibility was first selected by the U.N. in 1964. After much discussion and comments among and by the states as well as working groups, special reporters, etc., the International Law Commission of the U.N. adopted the entire draft articles on Responsibility of states for internationally wrongful acts, with commentaries in 2001. Since

states that ”There is a breach of an international obligation by a State when an act of the State is not in conformity with what is required of it by that obligation, regardless of its origin or character.” The Commentary to the ILC Draft clarifies that “international obligation” includes decisions rendered by an arbitral tribunal. [478] Therefore, it seems that an arbitral decision is an international obligation under the meaning of the ILC Draft, and a refusal to honor the arbitral decision would arguably constitute a breach of an international obligation. However, though dis-honoring of a foreign arbitral decision would constitute a breach of international obligation, the government still may refuse to perform the arbitral award voluntarily. To address such situation, the ILC Draft discusses countermeasures that may be taken by an “injured state” against a state responsible for an internationally wrongful act, but such countermeasures are limited to non-performance of international obligations of the State taking the measures against the responsible state. In other words, a state is allowed not to perform its obligation towards the second state that has ignored the arbitral decision until the second state performs the arbitral decision. However, because this only indirectly encourages the performance of international obligation, its impact is somewhat limited, and the possibility that such counter-measures can cause unwanted political tension exists. [479]

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then, the General Assembly have been commending the ILC Draft to the attention of governments and requested the Secretary-General to invite governments to submit further written comments on any future action regarding the articles. The General Assembly also requested the Secretary-General to update the compilation of decisions of international courts, tribunals and other bodies referring to the articles and to invite governments to submit information on their practice in this regard. This topic is included in the provisional agenda of for 2013 session. More information is *available at* http://untreaty.un.org/ilc/guide/9_6.htm.

[478] A judgment given between two states by the International Court of Justice or another tribunal…

[479] Yoo, Hyung-Jeong, *A Study of Methods of Enforcement of International Judgments and Awards*, 19 YONSEI L. REV. (2009) (유형정, 국제판결 및 중재판정의 이행강제방법에 관한 고찰, 법학연구 제 19 권 2 호, 연세대학교 법학연구소, 2009.)

Furthermore, in tax arbitration cases, it is not the State that is injured. Even though the parties to the arbitration are the States, the injured party is a taxpayer, who cannot bring any countermeasures on its own.

3. The OECD Approach

Paragraph 18 (Final Decision) and Paragraph 19 (Implementing the Arbitration Decision) are the two provisions in the OECD Sample Agreement that deal with recognition and enforcement of an arbitration decision. It seems that the OECD considered the enforceability of arbitral decisions, but failed to appreciate the difference between arbitral decisions and mutual agreements in terms of enforceability when drafting Paragraph 18 and 19; Paragraph 18 and Paragraph 19 of the Sample Agreement seem to conceptually conflict with each other.
Paragraph 18 of the OECD Sample Agreement provides:

> *[T]he arbitration decision shall be final, unless that decision is found to be unenforceable by the courts of one of the Contracting States because of a violation of paragraph 5 of Article 25 or of any procedural rule included in the Terms of Reference or in this agreement that may reasonably have affected the decision. If a decision is found to be unenforceable for one of these reasons, the request for arbitration shall be considered not to have been made and the arbitration process shall be considered not to have taken place (except for the purposes of paragraphs 8 "Communication of information and confidentiality" and 13 "Costs").*

As implied by the expression *"found to be unenforceable by the courts"* this paragraph necessarily assumes that the arbitral decision is to be enforced: The

foregoing phrase further implies that such enforcement can be sought through the domestic court of the country in which the enforcement is sought. As mentioned above, the word "enforcement" carries the implication that financial interest included in the arbitral decision is being sought to be enforced.[480]

On the other hand, Paragraph 19 states that *"the competent authorities will implement the arbitration decision . . . by reaching a mutual agreement on the case that led to the arbitration."*—this represents the basic position of the OECD.

When the two Paragraphs are analyzed together, it does not seem logical that the arbitral decision is to be implemented by the competent authorities by reaching a mutual agreement, while, at the same time, it is envisaged that the arbitral decision can be enforced separately through a court. A mutual agreement is an agreement between two competent authorities that one of the competent authorities would agree to cancel a tax assessment subject to acceptance by the taxpayer. Because it is an agreement between the two competent authorities, it does not provide the taxpayer with a right to enforce it.[481] After all, the taxpayer, who has the financial interest in the case, is not a party to the agreement, and would not have standing to enforce the agreement.

4. Sub-Conclusion

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[480] *See infra* n.501.
[481] *See infra* Ch. 4, Part II, Sec. C for discussion on interaction between tax treaty and domestic law.

As discussed in Chapter 2, Part II.E.2., one of the critical limitations of the MAP is that the competent authority, whose primary job is to ensure appropriate collection of taxes, may not accept the request of a MAP by taxpayers. Also discussed was the occasional tendency of competent authorities unwilling to resolve taxpayer's issues; this issue is caused by the inherent conflict of interests between the competent authority and the taxpayer, depriving the taxpayers of trust and confidence in their competent authority. Arbitration is intended to ameliorate some of these problems, and, somewhat paradoxically, to encourage the use and development of the MAP. For example, arbitration encourages the competent authorities to produce a final answer when the competent authorities otherwise may not reach an answer for an indefinite period of time, a phenomenon frequently pointed out as one of the most problematic aspects of the MAP. Arbitrations are decided by independent third persons who are objective unlike in the MAPs, which are decided by the competent authorities who lack objectivity and independence as the tax assessor of the taxpayers. Arbitration proceedings are more transparent with taxpayers with respect to opportunities to represent themselves.[482] Arbitrators address each dispute on its merits, and there is no room for package deals.

However, the problems of the MAP are likely to persist as long as (1) the arbitration is not self-operational due to the lack of its ability to be recognized and enforced; and (2) the arbitral decision remains to be implemented through the MAP. In such case, the potential advantages of arbitration can turn into meaningless waste the time, resources, and efforts of competent authorities and

[482] *See generally supra* Ch. 3.

the taxpayers without achieving its original purposes of ameliorating the issues found with the MAP and encouraging the use thereof.

CHAPTER 5. RECOGNITION AND ENFORCEMENT OF ARBITRAL DECISIONS: THE KOREAN CASE

I. How the Arbitral Decision can be Implemented in Korea

A. Implementation of Mutual Agreement in Korea

The Korean tax law is silent on whether the taxpayer has an option to reject the mutual agreement reached by the two governments. Apparently, however, legislative materials [483] assumed that mutual agreement would require acceptance the taxpayer,[484] who is free to choose between accepting the mutual agreement and resorting to the domestic course of remedy.[485]

The relationship between the MAP and the domestic course of remedy in Korea is found in the International Tax Coordination Act of Korea. The relevant

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[483] 1995 Revised Tax Law, Selected Sections, Art. 7, Sec. Ga (1996) [hereinafter referred to as "RTLSS"] (The relevant publication states that if the taxpayer does not accept the result of the mutual agreement, the taxpayer can resort to other legal course of remedy, which implies that the mutual agreement is subject to the taxpayer's acceptance.) (95년 간추린 개정세법(1996), 7. 상호합의절차, 가. 제도의 의의중 "상호합의절차는 납세의무자의 신청에 의하여 양국 과세당국간의 협의가 이루어지지만 그 과정에서 납세의무자의 참여가 배제되기 때문에 순수한 정부간 협상으로 전환되는 특징이 있다. 다만, **상호합의결과에 대하여 납세의무자가 수용하지 않은 경우 다른 법적절차를 밟을 수 있기** 때문에 그만큼 한계가 있다.") (emphasis added).

[484] Also, according to a former NTS officer, in practice, taxpayers sign a statement to the effect that the taxpayers accept the result of the MAP. The reason for the NTS' having taxpayers sign such statements is because MAP is a consensual process.

[485] This effectively gives a Korean taxpayer an opportunity to enjoy both courses of remedies, and take the one that gives a better result it likes, (by monitoring the litigation, one can withdraw the litigation once it seems that the court decision will not be better than the mutual agreement), which is contrary to what OECD suggested in its Commentary. In practice, the Korean tax authority may ask the taxpayer to suspend the on-going litigation or suspend the MAP process on its own discretion. However, such request to the taxpayer or the suspension of a MAP is not clearly written into the relevant tax laws.

provisions seem to allow the taxpayer to pursue a MAP and litigation simultaneously, but a court decision is binding regardless of whether such decision is rendered during or after the MAP process.[486, 487]

Article 27(3) of the ITCA prescribes that the competent authority shall take necessary actions, such as cancellation of tax and amendment of taxes, in accordance with the result of the mutual agreement.[488] Article 27(4) of the ITCA[489] states that the mutual agreement would be treated as if it never existed if a court decision rendered after the mutual agreement holds differently from the outcome of the mutual agreement. The relationship between Paragraphs 3 and 4 of Article 27 is not entirely clear. On its face, Article 27(4) seems to allow either the taxpayer or the competent authority to bring or continue a legal action despite the presence of a mutual agreement reached already, and the outcome of the legal action will override the mutual agreement to the extent that the two decisions are different. The legislators probably envisioned a case in which only the taxpayers bring a court action if they are not satisfied with the

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[486] ITCA, *supra* note 96, Art.23(4) (" Where the final decision is made by a court in the course of progressing the mutual agreement procedures, the date of the relevant final decision shall be the closing date of the mutual agreement procedures."). (국제조세조정에 관한 법률 23 조 [상호합의절차의 개시일과 종료일], ④ 상호합의절차가 진행 중일 때에 법원의 확정판결이 있는 경우에는 그 확정판결일을 상호합의절차의 종료일로 한다.)

[487] *Id.*, Art.27(4) ("Where a final decision is made by a court after the conclusion of the mutual agreement procedures, and the contents of such final decision are different from the terms and conditions mutually agreed, the said mutual agreement shall be deemed non-existent from the beginning."). (국제조세조정에 관한 법률 제 27 조 [상호합의 결과의 시행], ④ 상호합의절차가 종결된 후에 법원의 확정판결이 있는 경우로서 그 확정판결 내용이 그 상호합의 결과와 다를 때에는 그 상호합의는 처음부터 없었던 것으로 한다.)

[488] *Id.*, Art. 27(3). (국제조세조정에 관한 법률 제 27 조, ③ 과세당국이나 지방자치단체의 장은 상호합의 결과에 따라 부과처분, 경정결정 또는 그 밖에 세법상 필요한 조치를 하여야 한다.

[489] *Id.*, Art. 27(4) n.504.

mutual agreement reached by the two competent authorities.[490] Such expectation is correct since it is difficult to imagine a situation where the competent authority contests the agreement that it agreed to in the first place. After all, if the competent authority is not satisfied, then it can simply do nothing because (i) the competent authority will have already collected the tax from the taxpayer or made tax assessments; and (ii) the relevant provisions do not penalize the competent authority for not implementing the mutual agreement.

Nonetheless, in a rare case, if the Korean tax authority does not implement the mutual agreement despite of Article 27(3) of the ITCA, the affected taxpayer can request for correction of taxable income or tax liability to the NTS so that taxable income or tax liability is reduced.[491] If the NTS refuses to honor or does

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[490] RTLSS, *supra* note 483, Art. 7, Sec. Na (". . . the period during which the mutual agreement process is in pending shall not be counted towards calculating the statute of limitation for administrative hearing or administrative litigation, so as to **allow the domestic procedure to seek recognition of rights to be filed after the end of the mutual agreement process**.") ('95 년 간추린 개정세법(1996), 7. 상호합의절차, 나. 주요 입법내용중 "중략… 상호합의절차가 진행되는 기간은 행정심판 및 행정소송의 청구기간을 계산하는데 산입되지 않게 함으로써 **상호합의절차종료 후에도 국내 권리구제절차를 밟을 수 있도록 하였다**.") (emphasis added).

[491] National Tax Basic Law ("NTBL"), Art. 45-2(2). Any person who has filed tax return within the required due date, or who has the tax base and the amount of national tax decided upon, may request the decision or correction within two months from the date of knowing that the cause has occurred…in the following cases: 1. Where the transaction or act, etc., which is the ground of calculation of the tax base and tax amount in the initial return, decision, becomes different by a final judgment (including any reconciliation or other act having the same effect as the judgment) in the lawsuit against it; 2. . . . ; 3. Where the mutual agreement which is made under a tax treaty is carried out differently from the contents of the initial return or a decision.
(국세기본법 제 45-2 조【경정 등의 청구】2 항) ② 과세표준신고서를 법정신고기한까지 제출한 자 또는 국세의 과세표준 및 세액의 결정을 받은 자는…그 사유가 발생한 것을 안 날부터 2 개월 이내에 결정 또는 경정을 청구할 수 있다. 1. 최초의 신고·결정 또는 경정에서 과세표준 및 세액의 계산 근거가 된 거래 또는 행위 등이 그에 관한 소송에 대한 판결(판결과 같은 효력을 가지는 화해나 그 밖의 행위를 포함한다)에 의하여 다른 것으로 확정되었을 때; 2. . . .
3. 조세조약에 따른 상호합의가 최초의 신고·결정 또는 경정의 내용과 다르게 이루어졌을 때.

not act upon the request for correction, the affected taxpayer can appeal the NTS' action of not honoring the request for correction or the NTS' not acting upon the request for correction.[492] Again, this is highly unusual and very unlikely that the NTS would not honor the mutual agreement that the NTS agreed to with the other competent authority.

B. Implementation of Arbitral Decision through Mutual Agreement

The frame of the MAP does not change as long as arbitration is part of the MAP. Because the arbitral decision is to be implemented as a mutual agreement according to the OECD Model Tax Convention, the competent authority shall take necessary actions, such as cancellation of tax and amendment of taxes, to implement the arbitral decision under the Korean tax law.

However, the situation is different when the arbitral decision is forced to, rather than mutually agreed by, a competent authority, as a result of arbitration. An arbitral decision, albeit technically a mutual agreement, is not negotiated by the competent authorities, but is decided by a third party. It is possible that the competent authority would refuse to conclude a mutual agreement for implementing the decision. The issue is that the Korean tax law may fail to provide a remedy for the taxpayer in this event. Suppose the taxpayer, based on Article 27(3) of the ITCA and Article 45-2(2) of the NTBL, asks the NTS to make a correction on the tax assessment. If the NTS does not act or refuses the request for correction, the taxpayer can ask Korean domestic court for cancellation of tax assessment, claiming that the competent authority has an

[492] Appeal procedure is described *supra* in Part II below.

obligation to implement the arbitral decision through mutual agreement. If the domestic court holds that the competent authority indeed has an obligation to implement the arbitral decision through a mutual agreement based on Article 27(3), then the case would be over and there would be no further issue in terms of recognition and enforcement of the arbitral decision.

Another aspect of the ability of the affected taxpayer being able to ask for recognition and enforcement of the arbitral decision is that the taxpayer should not be allowed to pursue a litigation or continue with the litigation, if the taxpayer started litigation of the same issue with the domestic court already. As discussed earlier, the International Tax Coordination Act of Korea allows the taxpayer to pursue a MAP and litigation simultaneously and a court decision is binding regardless of whether such court decision is rendered during or after the MAP process. However, if it is the taxpayer who asked for arbitration and was allowed to participate in the arbitration, it does not seem fair to allow the same taxpayer to seek another remedy which can override the arbitral decision that the taxpayer asked for.

On the other hand, the court may decide that the taxpayer lacks the capacity to seek the cancellation of tax assessment based on the arbitral decision because the taxpayer was not a party to arbitration to begin with, and, the court may, therefore, dismiss the lawsuit.[493] Furthermore, even if the domestic court decides to entertain the case initiated by the taxpayer, it is not clear what the

[493] This issue can be potentially resolved if the taxpayer is given the status equivalent to a party to arbitration, as proposed throughout this paper, by having the taxpayer and represent itself participate in the arbitration, though there can be an argument that giving the status equivalent to a party to arbitration for the purpose of arbitration proceeding and for the purpose of enforcement of arbitral decision can be different.

scope of review by the court will be. Article 27(4) states that the court decision will prevail over the mutual agreement (i.e., the arbitral decision), implying that the court can do a de novo review of the case and render a decision that is different from the arbitral decision. A court decision in complete disregard of the arbitral decision would defeat the purpose of the legal action brought by the taxpayer, which is to have the arbitral decision implemented.

A simple solution to this would be to revise Article 45-2(2) to include arbitral decision as a basis for the taxpayer to request for correction. For example, subparagraph 1 of Article 45-2(2) can be revised as follows:

> 1. Where the transaction or act, etc., which is the ground of calculation of the tax base and tax amount in the initial return, decision, becomes different by a final judgment (including any reconciliation, ***arbitral decision*** or other act having the same effect as the judgment) in the lawsuit against it;

Alternatively, subparagraph 3 of Article 45-2(2) can be revised to read as follows:

> "Where the mutual agreement, ***including an arbitral decision,*** which is made under a tax treaty is carried out differently from the contents of the initial return or a decision." *(emphasis added in bold)*

Another simple solution would be to specifically state in the treaty that arbitral decision shall be considered to be a mutual agreement by the competent authorities if the competent authorities fail to implement the arbitral decision by reaching a mutual agreement within certain time period. Once this time period lapses, Korean taxpayer can activate Article 45-2(2) and make a request for correction to the Korean tax authority.

However, this solution requires the amendment of tax laws, which is the job of the legislative branch of the Korean government, the Ministry of Finance and Strategy, and the amendment of tax laws may not always be timely leaving the deficiency in the domestic remedy under the relevant tax laws. Even if it is to be assumed that Article 27(3) of the ITCA and Article 45-2(2) would provide a sufficient basis to ask for recognition of arbitral decisions, Korea's treaty partner countries may not have a corresponding legal basis to do so. Therefore, for the sake of balance and consistency with respect to recognition of arbitral decisions by the countries involved, it would be helpful to have a framework within the treaty. Accordingly, it is necessary to analyze of building a mechanism in the tax treaty for the purpose of having the arbitral decision recognized rather than relying on the domestic law in case one of the competent authorities does not voluntarily implement the arbitral decision,[494]

II. Potential Forms and Scope of Arbitral Decision

Having discussed the need for a bilateral mechanism through which the arbitral decision is recognized outside of the MAP system separate from domestic law, even though such situation would be very rare in practice and risk is rather theoretical in nature, discussed in this section is what form of arbitral decision would best-serve the original purpose of arbitration—that is to resolve tax dispute.

[494] This is closely related to the status of taxpayer with respect to the arbitral decision, which is discussed separately in *supra* Ch. 4, Part II. Sec.B.

The most desirable form of decision from an arbitral tribunal would be a court order for refund of the tax. The second possibility would be a cancellation of the tax assessment at issue, which is the form of decision that a Korean administrative court would render if the cases were adjudicated by the court. The third type of the decision would be to order the competent authorities to cancel the tax assessment at issue, obligating the relevant competent authority to take an action.

Whether all three types of decisions mentioned in the previous paragraph will be enforceable in a given State will depend on the State's tax system and tax policy. Analysis in this section again is within the context of Korean law, but would well extend to other legal systems.

A. Tax Appeal Procedure in Korea

Generally, if a taxpayer does not agree with the NTS' proposed tax assessment, the taxpayer is given an opportunity to contest it by asking the NTS to review the adequacy of such potential tax assessment.[495] If the taxpayer is successful in this pre-assessment appeal, then the case is closed and the NTS will not be able to pursue the case any further. If the taxpayer is not successful, however, then the tax assessment is made and the taxpayer can bring a tax appeal either to the NTS itself of the Tax Tribunal, both of which are administrative appeals.[496] If the taxpayer loses the case at the administrative appeal level, then the taxpayer can bring to an administrative court an administrative litigation challenging the

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[495] National Tax Basic Law, Art. 55(3). (국세기본법 제 55 조 3 항.)
[496] *Id.*, Art. 55(2).

"action of tax assessment" of the tax authority. This administrative litigation is brought against the NTS and the core of this administrative action is to ask the administrative court to cancel the "action" carried out in the form of tax assessment.[497] Where the taxpayer wins the case and yet the tax authority fails to issue a refund notwithstanding an administrative decision for cancellation of tax assessment, the taxpayer needs to bring another legal action to a civil court for the "return of unjust enrichment." This civil action is brought against the Republic of Korea, and the court decision would confirm the taxpayer's monetary right, which the taxpayer can enforce against the government through another court procedure.[498]

B. Arbitral Order for a Tax Refund

The first possible form of decision is for the arbitral tribunal to order the cancellation of tax assessment and the refund of related tax to the taxpayer, which would have the effect of settling two issues in one step. This raises an issue of whether it is permissible to provide the arbitral tribunal, a non-Korean government institution, with such authority. There is a possible argument that the arbitral tribunal can be provided with such authority if the two governments so agree in a tax treaty. Under the Korean Constitution, a tax treaty has the status of domestic law, therefore, as long as it is written into the tax treaty and agreed by the two States, it may be possible to extend such authority to the international arbitral tribunal. The idea, however, sounds impracticable and

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[497] Under the principle of separation of power, judicial review of administrative action is limited to review the actions taken by an administrative agency and the judicial body cannot replace the administrative agency in making a decision which action to take.

[498] Civil Act, Chapter 4, Art. 741~ 719, Unjust Enrichment. (민법 제 4 장 741~ 749 조, 부당이득.) Compulsory Execution of Foreign Judgment.

unsupportable. The scope of the decisions that the Korean administrative court can render against the NTS' tax assessment is limited to cancelling the action taken by the administrative agency. Korean administrative court cannot directly entitle a taxpayer directly seek refund from the NTS. Though the NTS always honors the administrative court decision and refunds the money to the taxpayer, at least in theory, the taxpayer must raise another civil action against the NTS if the NTS sits on the administrative court judgment. Vesting the arbitral tribunal with the authority to do more than what the Korean court can do may raise an issue of imbalance and inequity between the two judicial bodies, especially given that the international arbitral tribunal is not even a Korean judicial body.

Furthermore, in order for the arbitral tribunal to order a refund of money, the Korean government itself has to be named as a party to arbitration. However, the usual party to arbitration is the NTS, a Korean tax agency, not the Republic of Korea. The NTS is not a proper governmental agency to represent Korea in its foreign relations, therefore, it is not possible for the arbitral tribunal to render a decision ordering the Korean government to make a refund of tax. One may ask whether it is even possible to name the Republic of Korea as a party to arbitration. Although it is probably possible, in such case, the responsible party to arbitration would become the Ministry of Foreign Affairs and Trade, not the NTS, which would be simply unacceptable to all states.

The issue here is not simply whether it is technically possible to provide the arbitral tribunal with the authority to do more than what the Korean administrative court can do or to name the Republic of Korea as a party to arbitration. Rather, it is a matter of whether any State would allow the international arbitral tribunal with such authority and whether any sovereign

nation would concede to being named as a party to a MAP or tax arbitration, which seems almost impossible.

C. Cancelling Tax Assessment

The second possible form of arbitral decision is to have the arbitral tribunal cancel the tax assessment at issue. Such decision would be equivalent, in terms of scope, to a decision of the Korean administrative court, and raises less concern with respect to the balance and equity between the domestic court and the international arbitral tribunal. Furthermore, cancelling a tax assessment is within the power of the NTS.

However, as a requisite matter before endorsing this second type of decision, some of the threshold questions should be answered as to (i) whether an arbitral tribunal can and should be allowed to render such decisions; and (ii) if so, how it can be recognized in domestic courts as equivalent to a final domestic court decision.

With respect to the first issue, it should be noted that, unlike most commercial arbitration decisions, cancellation of tax assessment does not order the competent authorities to perform an action; instead, it directly cancels the tax assessment itself.[499] Accordingly, it ought to be determined whether an arbitral tribunal should be allowed to render decisions to that effect, and for this issue, we can perhaps find wisdom from another area of law. One of the most representative examples of judgments that directly forms a legal relation is a

[499] It is called hyung-sung-pan-gyeol (형성판결) in Korean.

divorce decree. While a divorce is usually declared by a family court judge, it can also be declared by a conciliation committee within the family court. [500] The fact that the conciliation committee, which is not a court, can render a decision may suggest that the arbitral tribunal could be given the same authority, and, in fact, for the arbitral decisions to have any meaning, the tribunals also should be so allowed to render decisions that directly cancels the tax assessment.

Mechanism for recognition

As discussed above, the arbitral tribunal's decisions might become useless if they are not recognized in domestic courts as equivalent to a final domestic court decision. Given the importance of recognition, the question now becomes how it can be recognized.

The two governments can agree and include a provision in the tax treaty that they will recognize the arbitral decision in accordance with the relevant domestic law provisions.[501] Recognition of foreign arbitral decisions in Korea is governed by the Arbitration Act. The Arbitration Act was completely revised effective 2000 through the adoption of the Model Law of UNCITRAL,[502] and it now regulates both domestic as well as international arbitrations.[503] The Arbitration Act is primarily for commercial arbitrations, and tax treaty arbitrations were not taken into consideration when the Act was revised. In fact,

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[500] It is called jo-jeong-wi-won-whe (조정위원회)in Korean. The conciliation committee is comprised of non-legal experts, as well as legal experts.
[501] Similar provision is included in the New York Convention, Article III.
[502] *See infra*, Ch. 5., Part III, Sec.B for discussion on the Model Law.
[503] Suk Kwang Hyun, 국제상사중재법연구 제 1 권 [Essays in International Commercial Arbitration Law 1] 1, 55-57 (2007).

Article 1 of the Arbitration Act specifically limits the scope of the laws to settlement of disputes in private laws.[504] Because governmental fiscal matters are not private by their nature, it seems that tax arbitration decisions would be outside the scope of the Arbitration Act of Korea.

One possible solution is to revise the Arbitration Act so that it would include a provision that requires arbitral decisions on tax matters to be recognized and enforced in accordance with Article 39[505] notwithstanding Article 1. However, this seems to be an unrealistic solution to problems that only may occur, if at all, in the future.

Alternatively, a provision stating the States' intention that the treaty prevails over inconsistent national arbitration statutes and/or case laws can be included in a tax treaty. However, this is not realistic either because (i) allowing a tax treaty to override the entire national arbitration statutes is too broad and leaves a large room for interpretation and speculation as to what specific provision(s) of the national arbitration statutes are to be overridden, which can lead to another dispute; and (ii) it is questionable whether the States should have the authority to negotiate a treaty that will override the entire arbitration law of a

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[504] Arbitration Act, Art. 1 ("The purpose of this Act is to ensure the proper, impartial and rapid settlement of disputes in private laws by arbitration.") (중재법 제 1 조 [목적]: 이 법은 중재에 의하여 사법상의 분쟁을 적정, 공평, 신속하게 해결함을 목적으로 한다.).

[505] *Id*., Art. 39(2) (providing that Article 217 of the Code of Civil Procedure and Articles 26(1) / 27 of the Civil Execution Act apply for recognition or execution of a foreign arbitral awards that have no applicable arbitration conventions.) (중재법 제 39 조(외국 중재판정) ① 「외국 중재판정의 승인 및 집행에 관한 협약」을 적용받는 외국 중재판정의 승인 또는 집행은 같은 협약에 따라 한다. ② 「외국 중재판정의 승인 및 집행에 관한 협약」을 적용받지 아니하는 외국 중재판정의 승인 또는 집행에 관하여는 「민사소송법」 제 217 조, 「민사집행법」 제 26 조제 1 항 및 제 27 조를 준용한다.)

country.

Another alternative is to provide a separate provision in the tax treaty to the effect that the arbitral decision is to be recognized in accordance with Article 217 of the Code of Civil Procedure of Korea. One obvious problem with this idea is Article 217 of the Code only covers foreign court judgments and not arbitration decisions. True, Article 2\39(2) of the Arbitration Act subjects an arbitral award to the same Article 217 of the Code as foreign court judgment, but this would not help because the Arbitration Act itself would not cover a tax arbitration and thus the term 'arbitral award' in Article 39)2) of the Arbitration Act would not include a tax arbitration decision. Moreover, one can raise an issue that the nature of the tax arbitral decision is not civil, but administrative, because, in Korea, the Administrative Litigation Act governs recognition of administrative decisions in place of the Code of Civil Procdure. The Administrative Litigation Act of Korea lacks a provision on recognition of foreign court decisions or foreign arbitral decisions. In the absence of such provision, the Code of Civil Procedure should be applicable[506] and one may resort to the Code of Civil Procedure for recognition of a foreign arbitral decision.

D. Ordering Competent Authority to Cancel Tax Assessment

The third type of decisions would be to order the competent authorities to

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[506] Article 8 of Administrative Litigation Act provides that Code of Civil Procedure or Civil Execution Act shall apply for matters not dealt with in the Administrative Litigation Act. (행정소송법 제 8 조 2 항에 의하면 '행정소송에 관하여 이 법에 특별한 규정이 없는 사항에 대하여는 법원조직법과 민사소송법 및 민사집행법의 규정을 준용한다' 라고 되어 있다.)

cancel the tax assessment at issue, requiring the relevant competent authority to take an action. A problem with this type of decision is that it is not the type of decision that a Korean court would render. In Korean legal theory, it is questionable that a plaintiff asks for a court judgment that orders an administrative agency to provide specific performance,[507] which is available only in civil or private matters.[508] Therefore, this type of decision is not the type of decision that would enable the taxpayer to ask for specific performance in Korea.

Accordingly, when the third type of decision is rendered and the competent authority against which the decision is rendered does not voluntarily cancel the tax assessment, the only remaining option for the taxpayer is to have the decision recognized through a legal action requesting the court to cancel the tax assessment based on the recognized decision. In Korea, the taxpayer would first need to go to a civil court for recognition of the original arbitral decision, then go to an administrative court to ask for cancellation of tax assessment, and finally go back to the civil court for the refund. This process is inefficient, costly, and time-consuming, especially considering that the same result can be obtained with less resource and within a shorter time period if the decision were of the second type.

E. Sub-Conclusion

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[507] It is called I-haeng-ui-so (이행의 소) in Korean.

[508] Administrative Procedure Act (2005) at 263 (providing that specific performance is available only in civil proceedings the purpose of which is to obtain order of specific performance.) (이행(履行)의 소는 이행청구권의 확정과 피고에 대한 이행명령을 목적으로 하는 소송을 말한다(법원실무제요 민사소송[Ⅰ], 법원행정처<2005>, 263 쪽).

It was discussed that there are three possible types of arbitral decisions. The first type of decision, i.e., to order a tax refund, is probably far beyond the scope that a sovereign nation would deem acceptable. The third type of decision is too inefficient, time-consuming, and costly. The only remaining option, therefore, is to allow the arbitral tribunal to render a decision that cancels the tax assessment, which, though not enforceable per se in Korea, can be recognized in accordance with the domestic law to permit further legal actions for enforcement. Given the impracticability of amending the Korean Arbitration Act, the Code of Civil Procedure, or the Administrative Litigation Act merely to protect the tax arbitration, a bilateral treaty would be the best place to have law to that effect. Accordingly, it is recommended that the tax treaty include a language that the Contracting States respect and recognize arbitral decisions as enforceable, which would be further supported by the arbitration agreement. For example, Article 25 can be revised to have a paragraph to include the following:

> "It is agreed that each competent authority shall respect the arbitral decision. It is also agreed that each competent authority shall recognize and implement the arbitral decision in.

At the same time, Paragraph 15 of the OECD Sample Agreement can be revised to include a short description of the form of arbitral decision to be rendered by the arbitral tribunal, which may read as follows:

> "The arbitral decision shall be in the form that the arbitral tribunal deems to be appropriate but, for double taxation cases, must include a

statement that "tax assessment made by the competent authority of country A (or B) is hereby cancelled."

The foregoing language stems from the Korean legal system. For other countries, of course, the exact scope and form of the arbitral decision should be discussed and formulated by the two competent authorities involved at the time the arbitration agreement is made so that the arbitral decision itself does not become the ground for another legal dispute after arbitration. Furthermore, this step of recognition can and should come only if the competent authority against which the arbitral decision is rendered does not reach a mutual agreement based on such arbitral decision within a certain time period, and fails to perform the decision voluntarily.

III. Recognition of Arbitral Decision in Korea

Statistics show that most commercial arbitral decisions are voluntarily executed by the parties.[509] In tax arbitrations, the likelihood of such voluntary execution is even higher, given that the parties are government agencies as opposed to private persons. However, the very issue of this section is to find out potential legal problems in recognizing tax arbitral decision. This section will analyze Korean procedural law regarding the recognition issue.

A. Scope of Review by Domestic Courts

As discussed above, tax arbitrations are likely to take place in one of the

[509] Redfern, *supra* note 243, at 622.

Contracting States, and the Contracting States would agree that the only courts that are allowed to examine the procedural fairness of the arbitration would be the ones in the country in which the recognition is sought.[510] There would be three possible variations in the scope of review: (1) review of substantive legal merits; (2) review of violation of basic procedural fairness only; or (3) no judicial review at all.[511] The first scope of review may not be appropriate unless the domestic court is prepared to deal with technical tax issues. Especially in countries where revenue rules are available, courts' exposure to tax issues would be limited and it would be more difficult to expect appropriate level of proficiency in tax issues from the courts. The third scope of review is not a viable option.

It seems that the second type of scope, i.e., a procedural review, is probably the most appropriate scope of review. The procedural review in principle would not be different between a tax arbitration and a commercial arbitration. For the sake of clarifying what is reviewable by domestic courts, the two governments should agree in advance to limit the scope of review to procedural fairness of arbitration if and only if domestic courts are asked to recognize the arbitration decision. Such an agreement would have the advantage of making the parties feel more comfortable about having the arbitration conducted in one of the

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[510] Judicial review of the arbitral process can occur: (i) immediately after the award at the arbitral situs, or (ii) when the award is presented for recognition at the place where there are economic consequences. The arbitral situs (also called the arbitral "seat" or the place of arbitration) will normally be designated in the arbitration agreement. The law of arbitral situs is an important element in commercial arbitrations because a third country is typically used as a place of arbitration and the laws of the arbitration place can influence the procedural aspects of the arbitration. Park, *supra* note 13, at 851.

[511] Park, *supra* note 13, at 852.

contracting states.[512] To analyze what procedural elements to cover and how to draft such language in a bilateral agreement, it would be necessary to review the law concerning commercial arbitrations.

B. New York Convention

The most important aspect of recognition of arbitral decisions is the ground that the court would rely on in denying the recognition of an arbitral decision. The Arbitration Act of Korea has a provision specifying the grounds for refusing enforcement of arbitral decisions.[513] Grounds for refusing to recognize or enforce arbitral decisions vary from country to country. For example, Korea adopted the Model Law, which closely resembles the New York Convention.[514] France exercises minimal control over arbitral decisions, while the U.K. has various control mechanisms in its arbitration related laws and regulations.[515] In light of these differences among the States, establishing a uniform set of rules on recognition of arbitral decision would reduce the chances of producing unexpected outcomes. It is discussed below whether it is feasible to adopt the New York Convention for recognition and/or enforcement of tax arbitrations and concludes that it is indeed not possible to adopt the New York Convention

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[512] One obvious concern with such a system is that there might be inconsistent judicial decisions on the matter of procedural fairness. For example, a taxpayer that felt the arbitrators had not given him/her an adequate opportunity for presentation of the case might find courts in one country more sympathetic than those of another, due to different approaches to due process. It seems that there is not much one can do about such national variations in concepts of fairness and jurisdiction unless the parties decide to ask a supra-national institution, for example, the International Court of Justice, to evaluate jurisdictional and other procedural challenges.

[513] Arbitration Law, Art. 36 (중재법 제 36 조).

[514] *See supra*, Ch. 3, Part I, for discussion on the New York Convention; *see also* Suk, *supra* note 501, at 245-371 for comprehensive discussion on same.

[515] Suk, *supra* note 501, at 197.

into a tax treaty. As an alternative, it discusses which specific provisions of the New York Convention can be partially adopted into a tax treaty.

The scope of the New York Convention is very broad as all arbitral awards fall within the scope of the Convention if they are made abroad or are not considered domestic.[516] However, the coverage is narrowed down due to the reservations made by some countries on the reciprocity and commercial relationship. Korea made reservations so that the New York Convention applies only (i) if the arbitral decisions are made in another Contracting State, (ii) for a dispute that is considered "commercial" under the national law and (iii) between persons, natural or juridical.[517] As a result, it seems difficult for Korea to adopt the New York Convention for tax arbitrations unless the two States agree to have the New York Convention incorporated into the relevant tax treaty. The tax treaty that incorporates the New York Convention would provide that (i) the arbitral decisions are deemed to have been made in the Contracting States, or vice versa; that (ii) the Contracting States would be considered to be "persons" for purposes of applying the New York Convention; and that (iii) the dispute is considered "commercial" for the purpose of applying the New York

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[516] Article I(1) of the New York Convention which provides "[t]his Convention shall apply to the recognition and enforcement of arbitral awards made in the territory of a State other than the State where the recognition and enforcement of such awards are sought, and arising out of differences between persons, whether physical or legal. It shall also apply to arbitral awards not considered as domestic awards in the State where their recognition and enforcement are sought."

[517] The exact language of the declaration and reservation statement made by Korean government is as follows: "By virtue of paragraph 3 of article I of the present Convention, the Government of the Republic of Korea declares that it will apply the Convention to the recognition and enforcement of arbitral awards made only in the territory of another Contracting State. It further declares that it will apply the Convention only to differences arising out of legal relationships, whether contractual or not, which are considered as commercial under its national law." *See* http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=XXII-1&chapter=22&lang=en#EndDec, viewed on October 28, 2012.

Convention.[518] However, the third requirement poses an issue because Korea made a reservation to the New York Convention that the dispute needs to be commercial for Korean law purposes. When Korea specifically inserted a requirement in the New York Convention that the dispute must qualify as 'commercial' for Korean law purposes, it is not just feasible for Korea to agree otherwise that fiscal disputes are to be regarded as commercial for purpose of applying the New York Convention because it is an irreconcilable conflict between the two as fiscal disputes are not commercial for Korean law purposes. Accordingly, it does not seem possible to adopt the New York Convention with respect to recognition and enforcement of tax treaty arbitrations in Korea. Furthermore, the New York Convention should be analyzed in its entirety in the context of tax arbitrations so that it does not conflict with the tax treaty and/or domestic tax laws and arbitration laws--however, this is beyond the scope of this paper. It seems that the OECD also considered adopting the New York Convention with respect to recognition and enforcement of arbitral decisions, but decided otherwise because the OECD intended the arbitration itself to be a process used for the MAP.[519]

C. Grounds for Refusal to Recognize Arbitral Decision

The New York Convention lists seven specific circumstances in which recognition and enforcement of the award may be denied:[520]

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[518] Park, *supra* note 13, at 840-41; Redfern, *supra* note 243, at 634-637.

[519] Org. of Econ. Co-Operation & Dev. [OECD] Fiscal Affairs Comm., *Response of the Committee on Fiscal Affairs to the Comments Received on the April Discussion Draft on the 2008 Update to the Model Tax Convention* (2008) at 7.

[520] Article V of the New York Convention. The full text of the New York Convention is reproduced in Appendix V at the end of this paper. Also, even though the New York Convention envisages both recognition and enforcement of arbitral awards, the scope is necessarily

1) Parties were under incapacity; the arbitration agreement is invalid;
2) Parties were not given proper notice of the appointment of arbitrator, or of the arbitration proceedings or were otherwise unable to present his case;
3) The decision deals with a matter not contemplated by the terms of the arbitration or is beyond the scope of the arbitration;
4) The composition of arbitral tribunal or arbitral procedure was not in accordance with the agreement of the parties;
5) The award has not yet become binding on the parties, or has been set aside or suspended;
6) The subject matter of the dispute is not capable of settlement by arbitration under the law of that country; or
7) The recognition or enforcement of the award would be contrary to the public policy of that country.

Grounds (1) through (5) intend to ensure that the interest of the person against whom the arbitral decision is rendered is not unreasonably harmed. Accordingly, the burden of proof is placed on the person who claims that the arbitral decision should not be recognized. On the other hand, grounds (6) and (7) can be used by the reviewing courts at their own discretion as these two grounds are intended to protect the national interests of the country in which the recognition of the arbitral decision is sought.[521]

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narrowed to recognition only in this section for the reasons discussed above that it is not possible to have an arbitral decision that can be enforced in Korea due to the limitation imposed by the Korean legal system.

[521] Suk, *supra* note 501, at 271.

Regarding ground (1) (invalid agreement), the best approach would be to consider all parties (including the affected taxpayer) as having accepted arbitration at the time it initiates the mutual agreement procedure by having the treaty language provide to such effect.

Ground (6) (arbitrability of subject matter) can be potentially problematic because some countries may consider the tax matters to be non-arbitrable. The issue is two-fold: (i) whether it is constitutional to have a foreign arbitral tribunal adjudicate tax matters; and (ii) whether it is constitutional to give a foreign tax arbitral decision the effect of a final domestic judgment. As for the first issue, as discussed above,[522] it is not a violation of the Korean Constitution to give a non-Korean administrative body the authority to render a decision that is of equivalent weight in authority to administrative decisions in Korea. In terms of the second issue, foreign arbitral decision, are being recognized and enforced in Korea in commercial arbitration and there seems to be no reason that tax treaty arbitration should be subject to a different treatment. The fact that the subject matter is fiscal, i.e. tax-related, should not prevent fiscal matters being resolved through arbitration. In order to prevent this issue from being raised by one of the competent authorities as a defense for non-recognition of arbitral decision, it would be prudent to have the tax treaty state that fiscal matters are arbitrable and that neither government may invoke arbitrability as a ground for refusing to recognize the decision.[523]

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[522] See *supra* Ch. 4., Part IV. Sec. B.
[523] Yoshihiro Masui, *Treaty Arbitration from a Japanese perspective*, Bulletin-Tax Treaty Monitor, IBFD, (Jan. 2004).

Ground (7), public policy will be violated only when there has been a breach of the "most basic notions of morality and justice."[524] It does not seem reasonable to allow a public policy defense to arbitrations in which the States themselves are the parties. Therefore, this public policy defense can be waived from the beginning.

Regarding ground (5), this defense should be excluded from bilateral tax treaty arbitrations[525] as inappropriate because there will be only two countries where recognition will be sought; and the same two countries will agree that the place of arbitration will be in one of the Contracting States. Therefore, the court of the country in which recognition is sought should be allowed to review the arbitral decisions only to the extent that such review is related to procedural defects.

Unlike the foregoing grounds, grounds (2) to (4) should be considered and adopted in tax treaties and arbitration agreements as valid grounds for denial of recognition and enforcement of arbitral decisions. They are of procedural nature, which will probably be the most commonly cited grounds on which the

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[524] Park discusses two cases: Parsons & Whittemore Overseas Co. v. Societe Generale de l'*Industrie du Papier (RAKTA), 508 F.2d 969, 974 (2d Cir. 1974)* (rejecting a public policy defense related to a rupture in diplomatic relations between Egypt and the United States); *Laminoirs-Trefileries-Cableries de Lens, S.A. v. Southwire Co., 484 F. Supp. 1063 (N.D. Ga. 1980)* (an award was refused enforcement on public policy grounds (where French law called for a particularly high interest rate on late payment.). See Park, *supra* note 13, at 844.

[525] Many commercial arbitrations take place in a country other than the countries in which relevant parties reside. If arbitration takes place in London, which is one of the most popular places for arbitrations, and an English court vacates an award made in London, such award may lose its res judicata effect if it is presented for recognition in New York. However, tax treaty arbitrations are currently designed to take place in one of the relevant States and the courts of the country in which one of the parties reside should not be allowed to review applications for annulment of arbitral decisions.

parties can challenge the arbitral decision. These standards also help to safeguard the parties and taxpayers against procedural defects, such as bias, lack of opportunity to present one's case, and the arbitrator's jurisdictional mistakes or irregular composition of the arbitral tribunal. Such safeguard features should be explicitly considered and adopted by tax treaties and/or arbitration agreements.[526]

Another aspect that we see in the New York Convention is that it requires the arbitral decision to be binding instead of "being final."[527] As a result, the New York Convention does not require the person seeking the recognition of the arbitral decision to show that the arbitral decision is binding, but rather it places the burden of proof on the person who opposes the enforcement of the arbitral decision.[528] Adopting this feature in tax arbitrations would alleviate the burden for taxpayer by effectively placing on the competent authority the burden to prove that the arbitral decision should not be recognized in case the competent authority opposes recognition of the arbitral decision. Again, however, this feature may not be adopted when tax arbitration is in its infancy, because this feature is usually considered when tax arbitration system becomes more operational and is utilized more frequently by the business community.

D. Recognition under Code of Civil Procedure of Korea

As briefly discussed, the Arbitration Act of Korea adopted the New York Convention when the Act was revised in 1999. As a result, foreign arbitral

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[526] Park and Tillinghast, *supra* note 473, at 60.
[527] New York Convention, Art. III.
[528] Suk, *supra* note 501, at 254.

decisions that are subject to the New York Convention are to be recognized and enforced in Korea under the Arbitration Act. Foreign arbitral decisions that are not within the scope of New York Convention are to be recognized and/or enforced according to the Code of Civil Procedure and/or Civil Execution Act of Korea.[529]

1. Four Elements of Recognition

In Korea, foreign court decisions are recognized as valid when:[530]

1) International jurisdiction of such foreign court is recognized under the principles of an international jurisdiction, the Korean laws and regulations, or the relevant treaties;
2) A relevant person (unsuccessful defendant) received, pursuant to a lawful method, a service of summons or a document equivalent thereto, and a notice of date or an order, allowing the person with sufficient amount of time to defend itself;
3) Such judgment does not violate good morals and other social

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[529] Arbitration Act, *supra* note 509, Art. 39(2).

[530] Code of Civil Procedure, Art. 217.

민사소송법 제 217 조 (외국판결의 효력): 외국법원의 확정판결은 다음 각호의 요건을 모두 갖추어야 효력이 인정된다.

1. 대한민국의 법령 또는 조약에 따른 국제재판관할의 원칙상 그 외국법원의 제재판관할권이 인정될 것
2. 패소한 피고가 소장 또는 이에 준하는 서면 및 기일통지서나 명령을 적법한 방식에 따라 방어에 필요한 시간여유를 두고 송달 받았거나(공시송달이나 이와 비슷한 송달에 의한 경우를 제외한다) 송달 받지 아니하였더라도 소송에 응하였을 것
3. 그 판결의 효력을 인정하는 것이 대한민국의 선량한 풍속이나 그 밖의 사회질서에 어긋나지 아니할 것
4. 상호보증이 있을 것.

order of Korea; and

4) A mutual guarantee exists.

In general, a Korean court has international jurisdiction when a party or a case is substantively related to the Republic of Korea. Whether a party or a case is related to Korea is determined in light of the relevant domestic provisions on jurisdiction, i.e., certain subject matters that grant the jurisdiction to Korean courts are likely to grant international jurisdiction as well.[531] Thus, the fact that the arbitral decision is rendered ordering the Korean competent authority to cancel the tax assessment should be enough for Korean courts to exercise the international jurisdiction.

This paper assumes that the second and third elements have been satisfied for the purpose of analyzing the possibility of a foreign person seeking recognition of a foreign arbitral decision by the Korean court as going into the analysis of such topic would be highly technical and lack relevance to tax.

The only remaining element is mutual guarantee, also referred to as reciprocity. Reciprocity is deemed to exist between two countries when the requirements for recognition of a foreign decision in one country are not out of balance with those in the other country without any substantial difference. A relevant Supreme Court case further states that the existence of a treaty between the two countries is not required for establishing reciprocity. A reasonable expectation that the foreign decision would be recognized in the foreign country is

[531] Private International Act, Arts. 2(1)-(2) (국제사법 2 조 1 항-2 항).

sufficient.[532]

2. Reciprocity and Revenue Rule

If the taxpayer seeks to enforce a tax arbitral decision in the country in which the arbitral decision is rendered, there would be no reciprocity issue with respect to enforcing the judgment. Reciprocity, however, may be a problem in enforcing a foreign arbitral decision regarding a tax dispute, because of the revenue rule.

The revenue rule is a common law doctrine that emerged in England in the 18th century and was adopted by the U.S. jurisprudence in the 19th century by state courts which prevents one state from reviewing tax matters of another state.[533] Eventually, the U.S. Supreme Court heard the question whether tax judgments of sister states are entitled to full faith and credit, and whether recovery can be denied in state or federal courts merely because it involves taxes. The U.S. Supreme Court ruled that courts of one state are not required to entertain a suit to recover taxes levied under the statutes of another, but nevertheless to a certain extent abrogated the revenue rule by holding that full faith and credit should be given to judgments for such taxes levied by sister states except on a number of limited grounds.[534, 535]

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[532] Supreme Court, 2004.10.28. 2002 Da 74213. (대법원 2004.10.28.2002 다 74213)

[533] *See infra* the following section of this paper for discussion on such procedure in Korea. Brenda Mallinak, *The Revenue Rule: A Common Law Doctrine for the Twenty-First Century,* 16 DUKE J. COMP. & INT'L L. 79, (2006).

[534] Those limited grounds include: (1) the court issuing the judgment was without jurisdiction, (2) the judgment debt was previously discharged, (3) the cause of action resulting in judgment for which the state of the forum has not provided a court, and (4) there is possible fraud involved in the case.

However, this abrogation of the revenue rule does not apply to foreign judgments. Rather, the revenue rule was applied by common law countries, such as England, the U.S., and Canada, in the 20th century in denying claims by foreign governments for tax judgments made in the foreign countries. For example, in a 1979 British Columbia case,[536] the Ninth Circuit Court of the U.S. used the revenue rule to justify refusing to enforce a foreign tax judgment by relying on Judge Learned Hand's discussion of the revenue rule in a 1921 case:[537]

> *[T]o pass upon the provision of another state is beyond the powers of a court; it involves the relations between the state themselves, with which courts are incompetent to deal, and which are entrusted to other authorities...No court ought to undertake an inquiry which it cannot prosecute without determining whether those laws are consonant with its own notions of what is proper.*

The Ninth Circuit further stated that, if the revenue rule is changed, making such change is a functionally better-suited for the policy-making branches of the government, deferring the responsibility of changing the revenue rule to the legislative body.[538]

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[535] Milwaukee County v. M.E. White Co., 296 U.S. 268, 268 (1935).
[536] British Columbia v. Gilbertson, 597 F.2d 1161, (9th Cir. 1979). Canada sought enforcement of a certificate of assessment that had the same effect as the judgment of a court for taxes assessed against Oregon residents who engaged in logging in Canada and failed to pay the logging tax on the income.
[537] Moore v. Mitchell, 30 F.2d 600 (2nd Cir. 1929).
[538] *British*, 597 F.2d at 1161.

As it can be seen from the cases, the purpose of the revenue rule is not to protect domestic citizens, but to avoid enforcing taxation of another country as the court cannot decide the appropriateness of the tax liability imposed by another sovereignty. In fact, the majority of the U.S. states legislated revenue rules by specifically excluding tax judgments from the list of foreign judgments that the U.S. states would recognize and enforce.[539] The American Law Institute Restatement of the Law[540] specifically states that U.S. courts are not required to recognize or enforce judgments rendered by courts of foreign state for the collection of foreign taxes, fines, or penalties.[541] As a result, there is no reciprocity between Korea and a U.S. state because either (1) the states adopted the Restatement of the Law of Foreign Relations which excludes foreign tax judgments from being recognized and enforced; or (2) the state courts would refuse to recognize and enforce foreign tax judgments under the revenue rule.

One may refute that the revenue rule would apply in case where a foreign taxpayer seeks to execute tax arbitration decision against a government agency of another country; the revenue rule cases referred to above involve situations in which a foreign government seeks to enforce its tax judgment to persons residing in another country. Given that the underlying premise of the revenue rule is that domestic courts are not capable of determining the validity of tax judgments rendered under the laws of another country, it seems unlikely that the

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[539] Recognition and enforcement of foreign country judgments is a matter of state law in the U.S.

[540] "Restatements" are essentially model laws, designed to "clarify and synthesize" the common law in a particular field of law. State governments generally follow and adopt these restatements as basis for state legislation. Restatements are published by the American Law Institute (ALI).

[541] Restatement of the Law, Third, Foreign Relations Law of the United States, § 483 Recognition and Enforcement of Tax and Penal Judgments.

result would be different merely because the party seeking to enforce the tax judgment is a taxpayer, rather than a government agency; the revenue rule probably should apply to tax arbitration decisions in which an individual or a corporate entity seeks to enforce a judgment against the government as long as such arbitral decisions are made in accordance with the tax laws of another country.

As discussed above, the existence of the revenue rule leads to the lack of reciprocity for those countries that respect the revenue rule, including the U.S., Canada, Ireland, Australia, and the U.K.[542] The U.S. is the Korea's largest trading partner, and about one third of the APAs concluded by Korea were with the U.S. The percentage increases to over 40% when the U.K is also taken into account as of the end of 2010[543]. These statistics tell us that about 40% of tax arbitration cases may result in non-recognition of the decisions due to either the existence of the revenue rule or, in case of the U.S., the specific statutory provision not to recognize foreign tax judgments.

The hurdle created by the revenue rules can possibly be overcome through an agreement between the countries. Mallinak argues that tax treaties are the proper mechanism for creating reciprocal recognition of judgments for tax liabilities.[544] The issue is not that simple, however. First, the U.S. is reluctant to enter into an agreement that would abrogate the revenue rules.[545] Furthermore,

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[542] *See* Mallinak, *supra* note 531, at 88-94, 119 (indicating that these countries still respect the revenue rule).
[543] *Id.*
[544] *Id.*, at 94.
[545] *See id.*, at 94-97 for an in-depth discussion of treaties to abrogate the revenue rule and the reluctance by the U.S. to bind itself to do so.

even if the U.S. agreed to enter into an agreement to recognize foreign tax judgments or decisions, there would be another hurdle that each state would also have to agree to adopt the agreement because the recognition and enforcement of foreign judgments are entrusted to the hands of each state. This inherent limitation cannot be resolved completely. Even the New York Convention realizes and specifically mentions this inherent limitation by stating that federal government (non-unitary State) shall bring a favorable recommendation to the constituent states to take legislative actions to implement the New York Convention, but the Convention does not and cannot require each constituent state to be bound by the Convention because the constituent states are not parties to the Convention.[546]

E. Sub-Conclusion

Recognition and/or enforcement of an arbitral decision is a difficult concept given that the parties to the arbitration are the two governments, but not the taxpayers, and that the subject matter is fiscal, particularly when the arbitration is conducted as a continuation of the MAP.

As discussed above, the New York Convention provides valuable guidance in terms of how procedural defects can lead to a domestic court denying recognition of the arbitral decision. Therefore, it would be prudent to list up the procedural grounds upon which foreign arbitral decisions can be denied of its recognition specifically in a tax treaty, so that a domestic court can refer to them

[546] New York Convention, Art. XI(b).

when reviewing a case submitted for recognition of a foreign arbitral decision. The following is a list of some of the potential grounds as examples.[547]

(a) To obtain the recognition, the party applying for recognition shall, at the time of the application, supply the duly authenticated original decision or a duly certified copy thereof;

(b) If the said decision is not made in an official language of the country in which the decision is sought to be recognized, the party applying for the recognition of the decision shall produce a translation of the document into such language. The translation shall be certified by an official sworn translator or by a diplomatic or consular agent.[548]

(c) Recognition of the decision may be refused, at the request of the party against whom it is invoked, only if that party furnishes the proof that:[549]

① There was an arbitrator's bias or corruption; or

② The party against whom the decision is rendered was not given proper notice of the appointment of arbitrator or of the arbitration proceedings or were otherwise unable to present the case; or

③ The decision deals with a difference not contemplated by or not falling within the issues submitted to arbitration, or it

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[547] See *supra* Ch. 5, Part III. Sec. B. for in-depth discussion of New York Convention in terms of what is appropriate to be included in a tax treaty as potential grounds for denying the recognition of foreign arbitral decision and which ground should be specifically prevented to be used by the governments.

[548] Items (a) and (b) serve to ensure certain formalities in requesting recognition of arbitral decision to a domestic court. This language is adopted from the New York Convention, Art. IV.

[549] See *supra* Ch. 5, Part III. Sec.B.

contains decisions on matters beyond the scope of issues submitted to arbitration; or

④ The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties.

(d) Each contracting state irrevocably waives the right to assert that controversies subject to this article are non-arbitrable.[550]

(e) Public policy shall not be deemed to have been violated solely by reason of the arbitrator's substantive decision on the legal and factual merits of the case.[551]

(f) No award under this article shall be denied recognition by reason of the act of state doctrine (sovereign immunity).[552]

(g) Review of arbitral decisions shall be limited to the country in which recognition of the decision is being sought.[553]

Reciprocity will be an issue, particularly for those countries that respect the revenue rule. The two governments can explicitly agree in a relevant tax treaty that the reciprocity is deemed to exist for the purpose of recognition and enforcement of arbitral decisions. For a federal nation, like the U.S., it is still a matter of how each of the constituent state treats the treaty. This issue was dealt with within the New York Convention, and the drafters of the New York Convention seem to have decided that the best course of action for the federal government was to strongly recommend the constituent states to adopt the

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[550] See *id*.
[551] See *id*.
[552] See *supra* Ch. 4, Part III. Sec. D.1.
[553] See *supra* Ch. 4, Part III. Sec. A.

convention. In a tax arbitration situation, such approach may be the best approach at the present time.

CHAPTER 6. CONCLUSION

The mandatory arbitration system, as endorsed and recommended by the OECD in order to ease some of the issues associated with MAP, falls short of true arbitration. Most importantly, the competent authorities, which are parties to arbitration, are not able to initiate arbitration, but the request for arbitration must be made by the affected taxpayer, which is identical to the procedure for initiating a MAP. This feature of initiation by the affected taxpayer, who cannot even be a party to arbitration, renders the tax arbitration somewhat inefficient and procedurally inadequate. Furthermore, the arbitral decision is not recognizable or enforceable by the affected taxpayer who requested arbitration, but such arbitral decision is to be implemented through reaching a mutual agreement by the competent authorities, which may lead to a situation in which there is no final outcome of the case if the competent authorities do not reach a mutual agreement, though such situation, in which the competent authorities would not reach a mutual agreement to adopt the arbitral decision, would be rare in practice and may represent only a theoretical risk. Moreover, this arbitral decision in the form of mutual agreement can be rejected by the affected taxpayer causing all the resources and time devoted to arbitration become useless and wasted. The OECD envisaged the arbitration to be confined within the system of MAP and adopted 'procedural' arbitration within the system of MAP, and the end result is that such arbitration is another MAP.

In order to make tax arbitration to function as a true arbitration similar to commercial arbitration, many aspects of tax arbitration including recognition and enforcement of arbitral decision must be included in a tax treaty itself because the current arbitration mechanism is insufficient for tax arbitrations.

Particularly, the inability of the affected taxpayer to seek recognition and enforcement of arbitral decision comes from the fact that the affected taxpayer is not a party arbitration. This issue can be possibly resolved by providing the affected taxpayer the status necessary for such recognition and enforcement, i.e., provide the taxpayer with sufficient opportunity to participate in the arbitration proceeding so that the status of taxpayer becomes that of third party beneficiary. Having had sufficient opportunity to represent the interest of each party, all parties involved in arbitration would readily accept the outcome of arbitration and be entitled to ask for recognition and enforcement of the outcome of the arbitration. Assuming it is possible for the affected taxpayer to seek recognition and enforcement of the arbitral decision, there is another obstacle in terms of the domestic law provisions relating to such recognition and enforcement of foreign arbitral decisions. For example, the New York Convention will apply in Korea for recognition and enforcement of foreign arbitral decisions. However, tax arbitral decisions are excluded from the scope of the New York Convention as there is a specific requirement that the arbitral decisions must be commercial in nature in order to have the New York Convention apply for the purpose of recognition and enforcement of foreign arbitral decisions. Accordingly, due to the lack of the ability for the current arbitration system to apply on tax arbitrations and for the fact that it is necessary to provide the affected taxpayers the status equivalent to a party to arbitration, the provisions related to initiation of arbitration, the scope of arbitral decision, status of taxpayers in arbitration proceedings, and the recognition and enforcement of arbitral decision under the domestic laws, need to be incorporated in a tax treaty itself, which seem rather impractical and highly unrealistic.

Furthermore, even if it is assumed that it is feasible to include all substantive

provisions in a tax treaty, the recognition and enforcement of arbitral decision invokes the domestic laws of each country. For example, it is not possible to seek enforcement of a tax arbitral decision in Korea under the current laws and regulations. It requires the relevant law provision in the National Tax Basic Law to be revised to enable the affected taxpayer to seek enforcement of the foreign tax arbitral decision, which can be achieved if the basis upon which the affected taxpayer can request for correction of tax liability includes a situation in which an arbitral decision is rendered in favor of the taxpayer. In case there is no equivalent law provision in the treaty partner's country, a mechanism under which the arbitral decision can be recognized and enforced would need to be built into the tax treaty. For example, for Korea, such mechanism can be achieved by allowing the arbitral board to render a final and non-appealable arbitral decision which is equivalent to 'cancellation of a tax assessment decision' in Korea. However, entrusting the arbitrators with such authority to render a decision, that not only binds the sovereignty to act but also affects the taxing right of the sovereignty, seems to exceed the authority provided to arbitrators in commercial arbitrations, which is highly unusual and quite unrealistic.

This may be the reason why the OECD confined the tax arbitration to function within the system of MAP and, in essence, the OECD imported 'procedural arbitration' into the MAP. Nonetheless, the procedural arbitration adopted by the OECD should be improved because it is somewhat inefficient and time-consuming as the entire arbitration process as suggested by the OECD can take more than 2 years and it provides much discretion to the competent authorities but excludes taxpayers from the arbitration process, which is one of the shortcomings of MAP. This paper pointed out the inefficiency and suggested

improvements, when possible, at each step of the arbitration, including initiation of arbitration, formation of arbitral board, selection and qualification of arbitrators, format of arbitration, rendering of arbitral decision, and etc. so that the entire time frame can be reduced to less than a year, by comparing the arbitration system proposed by the OECD with that of the EU Transfer Pricing Arbitration Convention and the U.S. - Germany Tax Treaty (its 2006 Protocol), as both the EU Transfer Pricing Arbitration Convention and the U.S. - Germany Tax Treaty are two existing treaties that provide useful guidance on how the current OECD arbitration can be improved procedurally. These procedural improvements are suggested because the ultimate purpose of arbitration being introduced by the OECD is to bring an end to the disputes that have lasted for longer than two years already and it defeats the purpose of arbitration if arbitration itself takes longer than two years.

Appendix I is an exemplary arbitration provision and related sample agreement incorporating the proposals, suggestions and potential solutions made throughout this paper, both procedurally and substantively.[554] It may be far from perfect, but at least it is an attempt to show how the arbitration under the OECD Model Tax Convention, though confined within the ambit of MAP, may be modified and improved to become more efficient and self-operational so that it can better-serve the interests of the competent authorities and the taxpayers and evolve into a more effective and viable tool as an international tax dispute resolution method, which in turn would ultimately provide the competent authorities the incentive to work the MAP more promptly and efficiently.

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[554] See *infra* Appendix I for the comparison of the original Article 25(5) of the OECD Model Tax Convention (including the Sample Arbitration Agreement) and the suggested changes.

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[Abstract]

This paper raises a fundamental question as to whether the arbitration system as recommended by the OECD is workable. As a process of finding an answer to this question, this paper examined the history of tax treaties. Before World War II, there was a debate as to whether there should be a compulsory binding dispute resolution procedure for international tax treaties. International organizations, such as the ICC, and the Committees of the United Nations (or the League of Nations in early years) recommended establishing an international group of experts or a central tax tribunal to arbitrate or to provide tax opinions. However, eventually the model with the non-compulsory procedure was chosen at that time as it was the governments themselves that preferred negotiation based resolution of tax treaty disputes, which is how the current MAP was formally adopted by the OECD in 1964 and evolved to be the way it is now.

MAP works well for some taxpayers, but it has its own inherent limitations due to the conflicting interests among the parties involved; between the government and taxpayers and sometimes between the government agencies within the government. MAP requires the government to represent the interest of taxpayers in the MAP process. However, there is a fundamental question as to the government's ability and qualification to represent taxpayers' interests when MAP was requested by the taxpayer who believes that there was excessive tax assessment by the tax authority and one of the tax authority's interests is to collect tax revenue. These interests are inherently conflicting. Furthermore, MAP falls short of taxpayers' expectations due to the prolonged period of uncertainty, as a typical MAP takes average 2 years, many times longer, to resolve an issue, coupled with the taxpayers' lack of trust in and fear toward the

tax authority in certain cases.

It is a step forward in the history of tax treaties that the OECD endorsed ‘mandatory tax arbitration’ and released the OECD Model Tax Treaty which reflects such endorsement by including arbitration provision within Article 25. Arbitration system proposed by the OECD provides much procedural guidance. However, it is somewhat inefficient and time-consuming procedurally. This paper pointed out the inefficiency and suggested improvements, when possible, at each step of the arbitration, including initiation of arbitration, formation of arbitral board, selection and qualification of arbitrators, format of arbitration, rendering of arbitral decision, and etc. so that the entire time frame can be reduced to less than a year.

Aside from the procedural aspects, there are certain substantive issues with respect to the way the OECD envisaged arbitration. Most importantly, it is not clear whether the arbitration is truly mandatory. There are two perspectives; first, whether the initiation of arbitration is mandatory; and second, whether the outcome from arbitration is mandatorily binding to all parties involved including taxpayers. The arbitration model by the OECD achieves neither and it falls short of true arbitration. The essential feature to true arbitration is the ability to have the arbitral decision be recognized and enforced. It seems that the reason for absence of provision on recognition and enforcement of arbitral decision within the OECD Model Tax Treaty and making the arbitration be part of MAP is because the current arbitration mechanism for the purpose of recognition and enforcement would be insufficient to apply to tax arbitrations. Further, incorporating all aspects necessary for recognition and enforcement of tax arbitral decisions into a tax treaty seems unrealistic and impractical, though

not impossible.

At this time, perhaps, the greatest strength of arbitration as proposed by the OECD is its ability to drive the competent authorities to resolve MAP cases more promptly and efficiently because the competent authorities would not want to have third parties decide their taxing rights and not want to change their already established practices of mutual agreement procedure in which they have much discretion.

Keywords: mutual agreement procedure, international tax disputes, tax treaty disputes, tax treaty arbitration, Article 25 of the OECD Model Tax Treaty,

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APPENDIX I: COMPARISON OF OECD VERSION AND SUGGESTED CHANGES

OECD MODEL TAX TREATY	SUGGESTED CHANGES
Article 25(5) OECD Model Tax Convention	
5. 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, 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	5. 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 meets one of the qualifications under sub-paragraph (b) below; and (b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the date the case was first presented to one of the competent authorities in accordance with paragraph 1, any unresolved issues arising from the case shall be submitted to arbitration [555] by one of the competent authorities in the manner prescribed by, and subject to, the requirements of paragraph 6,

[555] See *supra* Ch. 4, Part II. Sec. A.

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.	7, and 8 this Article and of the Rules of Procedure, as attached hereto as Annex to be entered into at the time of initiating the mutual agreement procedure [556] under paragraph 2 of this Article. The competent authority shall obtain consent from the person who requested MAP under Paragraph 1 above. Such consent shall be deemed to have been granted if the person does not respond to the competent authority's request for consent to arbitration within 30 days from the date such request for consent is received by the taxpayer. [557] Notwithstanding the previous sentence, a case shall be eligible for arbitration if it is case: (i) that would result in taxation which is not in accordance with the provisions of this Convention;[558] or (ii) that the competent authorities agree to be suitable for determination by arbitration. 6. For the purpose of paragraph 5 and this paragraph, the following rules and definitions shall apply: (a) Notwithstanding the initiation of the arbitration proceeding,

[556] See *supra* Ch. 4, Part II. Sec. E.
[557] See *supra* Ch. 4, Part II. Sec. A.
[558] See *supra* Ch. 4, Part II. Sec. F.

	the competent authorities may reach a mutual agreement to resolve a case and terminate the arbitration proceeding if such mutual agreement is accepted by the person who requested arbitration. The concerned person may request continuation of arbitration proceeding when (i) double taxation is not fully resolved through a mutual agreement procedure; or (ii) if it believes that the mutual agreement is not consistent with the Convention.[559] (b) 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.[560] 7. The following rules shall apply for the purpose of recognition of arbitral decisions: [561]

[559] See *supra* Ch. 4, Part II. Sec. D.

[560] The original language of the OECD is kept unchanged because it is impossible, in many countries, to go to arbitration once there is a court decision under the domestic law. Please refer to Ch. 4., Part II. Sec. C. for the discussion of relationship between the domestic remedies and arbitration.

[561] See *supra* Ch. 4. Part II. Sec. B for discussion of binding effect of arbitral decision. The grounds for non-recognition listed under this paragraph mirror the essence of the bases for non-recognition set forth in Arts. V(1)(a)-(d) of the New York Convention (UN Convention) as discussed in Ch. 5., Part III. Sec. B.

	(a) It is agreed that each competent authority shall respect the arbitral decision. It is also agreed that each competent authority shall recognize and implement the arbitral decision in accordance with this Paragraph and the paragraph 13 and 14 of the Rules of Procedure.[562] (b) If the competent authority against which the arbitral decision is rendered does not implement the arbitral decision in accordance with paragraph 13 and 14 of the Rules of Procedure, such competent authority shall be deemed to have agreed on the binding effect of the arbitration decision and the taxpayer shall be entitled to have the arbitral decision recognized in accordance with the rules of procedure of the territory where the decision is being sought to be recognized, [563] subject to the conditions provided in the following sub-paragraphs. (c) To obtain the recognition mentioned in the preceding article, the party applying for

[562] See *supra* Ch.5, Part II. Sec. E.
[563] See *supra* Ch. 4, Part II, Sec. B.

	recognition shall, at the time of the application, supply (i) the duly authenticated original decision or a duly certified copy thereof; and (ii) the original arbitration agreement executed or a duly certified copy thereof. If the said decision or agreement is not made in an official language of the country in which the decision is being sought to be enforced, the party applying for recognition and enforcement of the decision shall produce a translation of these documents into such language. The translation shall be certified by an official sworn translator or by a diplomatic or consular agent. [564] (d) Recognition of the decision may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition is sought proof that:[565] ① There was an arbitrator's bias or corruption; or ② The party against whom the decision is being sought to be recognized was not given

[564] See *supra* Ch. 5, Part III, Sec. E.
[565] See *supra* Ch. 5. Part III. Sec. B.

	proper notice of the appointment of arbitrator or of the arbitration proceedings or were otherwise unable to present the case; or ③ The decision deals with a difference not contemplated by or not falling within the scope of issues submitted to arbitration, or it contains decisions on matters beyond the scope of issues submitted to arbitration; or ④ The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties. (e) Each contracting state irrevocably waives the right to assert that controversies subject to this article are non-arbitrable. (f) Public policy shall not be deemed to have been violated solely by reason of the arbitrator's substantive decision on the legal and factual merits of the case. (g) No arbitral decision under this article shall be denied recognition by reason of the act of state doctrine (sovereign immunity). (h) Review of arbitral decisions

	shall be limited to the country in which the decision is being sought to be recognized. 8. Should there be an inconsistency among paragraphs 5, 6 and 7 of this Article and the domestic laws of either contracting states, it is agreed that the treaty shall prevail.
Annex	
OECD MODEL TREATY	SUGGESTED CHANGES
Mutual Agreement on Arbitration	**Rules of Procedure**[566]
The competent authorities of [State A] and [State B] have entered into the following mutual agreement to establish the mode of application of the arbitration process provided for in paragraph 5 of Article 25 of the [title of the Convention], which entered into force on [date of entry into force]. The competent authorities may modify or supplement this agreement by an exchange of letters between them.	The competent authorities of [State A] and [State B] agree to establish the mode of application of the arbitration process provided for in paragraphs 5, 6, 7, and 8 of Article 25 of the [title of the Convention] in the manner provided herein. The competent authorities may modify or supplement this agreement by an exchange of letters between them.
1. Request for submission of case to arbitration	*1. Initiation of Arbitration*[567] (a) A request for arbitration shall be

[566] See *supra* Ch. 4. Part II. Sec. E. on discussion of arbitration agreement and the reason why it may be more appropriate to refer to it as ”Rules of Procedure.”

[567] See *supra* Ch. 4. Part II. Sec. B. and Part III. Sec. B. The specific language was referred from the EU Transfer Pricing Arbitration Convention.

A request that unresolved issues arising from a mutual agreement case be submitted to arbitration pursuant to paragraph 5 of Article 25 of the Convention (the "request for arbitration") shall be made in writing and sent to one of the competent authorities. The request shall contain sufficient information to identify the case. The request shall also be accompanied by a written statement by each of the persons who either made the request or is directly affected by the case that no decision on the same issues has already 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.	considered to have been presented on the date the first competent authority notifies the other competent authority (the second competent authority). The second competent authority shall confirm the receipt of the copy of the request for arbitration. (b) Unless otherwise agreed between the competent authorities, the competent authority that issued the tax assessment notice or a final decision of the tax administration (first competent authority) that became the subject matter of the MAP takes the initiative for the establishment of the arbitral tribunal and obtaining the consent from the taxpayer for arbitration.
2. Time for submission of the case to arbitration A request for arbitration may only be made after two years from the date on which a case presented to the competent authority of one Contracting State under paragraph 1 of Article 25 has also been presented to the competent	*This paragraph is eliminated as there is no need to submit information to the competent authorities because the competent authorities, which already have all information needed for arbitration, are*

authority of the other State. For this purpose, a case shall be considered to have been presented to the competent authority of the other State only if the following information has been presented: [the necessary information and documents will be specified in the agreement].	*required to initiate the arbitration.*
Refer to 5. [Selection of arbitrators] below.	*2. Selection of arbitrators*[568] (a) Unless the competent authorities of both contracting states and the concerned persons agree otherwise, the Arbitral Tribunal shall be composed of three members. Within three months after the second competent authority is in receipt of a notice of arbitration from the first competent authority, the competent authorities shall each appoint one arbitrator. (b) Within one month of the appointment, the arbitrators so appointed will appoint a third arbitrator who will function as the Chair. (c) If any appointment is not made within the required time period, the arbitrator(s) not yet

[568] See *supra* Ch. 4, Part. III, Sec. B.

	appointed shall 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 one of the competent authorities or the person who made the request for arbitration. (d) The same procedure shall apply with the necessary adjustments if, for any reason, it is necessary to replace an arbitrator after the arbitral process has begun.
Refer to paragraph 7. [Selection and eligibility of arbitrators] below.	*3. Eligibility of arbitrators*[569] (a) Any person may be appointed as an arbitrator, unless one of the following applies: (i) the person belongs to or is working on behalf of one of the tax administrations concerned; (ii) person has, or has had, a large holding in or is or has been an employee of or adviser to the presenter or concerned persons; (iii) the person does not offer a sufficient guarantee of objectivity for the

[569] See *Id*.

	settlement of the case or issues to be decided. (b) Each individual appointed to serve as an arbitrator shall disclose links to either contracting state or the taxpayer or any other concerned person that might create reasonable doubts about the individual's ability to render a fair decision. (c) An arbitrator shall be considered to have been appointed when a letter confirming that appointment has been signed both by the competent authority who has the power to appoint that arbitrator and by the arbitrator himself. (d) The Chairman must possess the qualifications required for appointment to the highest judicial offices in his country, be a juris scholar of recognized competence or a lawyer fluent in [languages appropriate for both parties], shall not have the nationality of either contracting states and shall be independent of the governments of both contracting states and the concerned persons. The Chairman shall have substantial experience in international arbitration and/or international taxation.

3. Terms of Reference Within three months after the request for arbitration 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 will constitute the "Terms of Reference" for the case. Notwithstanding the following paragraphs of this agreement, the competent authorities may also, in the Terms of Reference, provide procedural rules that are additional to, or different from, those included in these paragraphs and deal with such other matters as are deemed appropriate.	*This step is eliminated as this paper argues that Terms of Reference is not necessary in tax arbitrations.*
	4. Pre-Hearing Conference[570] (a) Within one month after all the arbitrators have been appointed as provided in paragraphs 2 and 3 above, the Chair shall communicate to the competent authorities and the person who

[570] See *supra* Ch. 4, Part. III, Sec. A. for discussion on terms of reference and a pre-hearing conference.

	made the request for arbitration in writing that (i) arbitration tribunal has been formed; (ii) summary of the issues (or the case) to be arbitrated based on the information received by arbitrators; and (iii) request for a pre-hearing conference, if necessary, so that all arbitrators, competent authorities and concerned persons gather together for an exchange of information, stipulation of uncontested facts and consideration of the issues (or case) in dispute with a view to reaching an amicable settlement. (b) If a settlement is reached out of the pre-hearing conference mentioned above in paragraph 4(a), such settlement shall constitute an arbitration decision.
5. Selection of arbitrators Within three months after the Terms of Reference have been received by the person who made the request for arbitration or, where paragraph 4 applies, within four months after the request for arbitration has been received by both competent authorities, the competent authorities shall each appoint one arbitrator. Within two	*This step is moved to Step 3 before the Pre-Hearing Conference.*

months of the latter appointment, the arbitrators so appointed will appoint a third arbitrator who will function as Chair. If any appointment is not made within the required time period, the arbitrator(s) not yet appointed shall 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. The same procedure shall apply with the necessary adaptations if for any reason it is necessary to replace an arbitrator after the arbitral process has begun. Unless the Terms of Reference provide otherwise, the remuneration of all arbitrators …. [the mode of remuneration should be described here; one possibility would be to refer to the method used in the Code of Conduct on the EC Arbitration Convention].	
6. Streamlined arbitration process If the competent authorities so indicate in the Terms of Reference (provided that these have not been agreed to after the selection of arbitrators pursuant to paragraph 4 above), the following rules shall apply to a particular case notwithstanding paragraphs 5, 11,	

15, 16 and 17 of this agreement: *a)* Within one month after the Terms of Reference have been received by the person who made the request for arbitration, the two competent authorities shall, by common consent, appoint one arbitrator. If, at the end of that period, the arbitrator has not yet been appointed, the arbitrator will 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 referred to in paragraph 1. The remuneration of the arbitrator shall be determined as follows … [the mode of remuneration should be described here; one possibility would be to refer to the method used in the Code of Conduct on the EC Arbitration Convention]. *b)* Within two months from the appointment of the arbitrator, each competent authority will present in writing to the arbitrator its own reply to the questions contained in the Terms of Reference. *c)* Within one month from having received the last of the replies from the competent authorities, the arbitrator will decide each question included in the Terms of Reference in accordance with one of the two	*This step is eliminated as this paper does not recommend a streamlined arbitration process.*

replies received from the competent authorities as regards that question and will notify the competent authorities of the choice, together with short reasons explaining that choice. Such decision will be implemented as provided in paragraph 19.	
7. Eligibility and appointment of arbitrators 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. An arbitrator will be considered to have been appointed when a letter confirming that appointment has been signed both by the person or persons who have the power to appoint that arbitrator and by the arbitrator himself.	*This step is moved to Step 3 above.*
8. Communication of information and confidentiality For the sole purposes of the application of the provisions of Articles 25 and 26, and of the	*5. Communication of information and confidentiality*[571] (a) The concerned person(s), and their authorized representatives or agents, must agree prior to the

[571] See *supra* Ch. 4, Part. III, Sec. C.1. for discussion on confidentiality.

domestic laws of the Contracting States, concerning the communication and the confidentiality of the information related to the case that results in the arbitration process, each arbitrator shall be designated as authorized representative of the competent authority that has appointed that arbitrator or, if that arbitrator has not been appointed exclusively by one competent authority, of the competent authority of the Contracting State to which the case giving rise to the arbitration was initially presented. For the purposes of this agreement, where a case giving rise to arbitration was initially presented simultaneously to both competent authorities, “the competent authority of the Contracting State to which the case giving rise to the arbitration was initially presented” means the competent authority referred to in paragraph 1 of Article 25.	beginning of arbitration proceedings not to disclose to any other person any information received during the course of the arbitration proceeding from either Contracting State or the arbitration board, other than the determination of such board subject to sub-paragraph (b) below; (b) For purposes of an arbitration proceeding under Paragraph 5 of Article 25, Paragraph 5 of the Convention and this Rules of Procedure, members of the arbitration board and their staffs shall be considered "persons or authorities" to whom information may be disclosed under Article 26 (Exchange of Information and Administrative Assistance) of the Convention."
9. Failure to provide information in a timely manner Notwithstanding paragraphs 5 and 6, where both competent authorities agree that the failure to resolve an issue within the two year period provided in paragraph 5 of Article	*This step is eliminated since it is envisaged that the competent authorities will provide all information necessary for arbitration.*

25 is mainly attributable to the failure of a person directly affected by the case to provide relevant information in a timely manner, the competent authorities may postpone the nomination of the arbitrator for a period of time corresponding to the delay in providing that information.	
10. Procedural and evidentiary rules Subject to this agreement and the Terms of Reference, the arbitrators shall adopt those procedural and evidentiary rules that they deem necessary to answer the questions set out in the Terms of Reference. They will have access to all information necessary to decide the issues submitted to arbitration, including confidential information. Unless the competent authorities agree otherwise, any information that was not available to both competent authorities before the request for arbitration was received by both of them shall not be taken into account for purposes of the decision.	*6. Procedural and evidentiary rules* [572] Subject to this agreement and the Pre-Hearing Conference, the arbitrators shall adopt those procedural and evidentiary rules that they deem necessary to decide the issues (or the case) submitted in the request for arbitration. They will have access to all information necessary to decide the issues submitted to arbitration, including confidential information. Unless the competent authorities agree otherwise, any information that was not available to both competent authorities before the request for arbitration was received by both of them shall not be taken into account for purposes of the decision.
11. Participation of the person who requested the arbitration	*7. Rights and obligations of taxpayers*[573]

[572] No change is suggested for this provision and is the same as the OECD version.

The person who made the request for arbitration may, either directly or through his representatives, present his position to the arbitrators in writing to the same extent that he can do so during the mutual agreement procedure. In addition, with the permission of the arbitrators, the person may present his position orally during the arbitration proceedings.	(a) The person who made the request for arbitration may, either directly or through his representatives, provide any information, evidence or documents which seem to them likely to be of use to the arbitration board in reaching a decision, and present his position to the arbitrators. In addition, the person may present his position orally during the arbitration proceedings. (b) The concerned persons and the competent authorities of the Contracting States shall give effect to any request made by the arbitration board to provide information, evidence or documents. If the arbitration board so requests, each of the concerned persons shall appear or be represented before it.
12. Logistical arrangements Unless agreed otherwise by the competent authorities, the competent authority to which the case giving rise to the arbitration was initially presented will be	*8. Logistical arrangements*[574] Unless agreed otherwise by the competent authorities, the competent authority to which the case giving rise to the arbitration was initially presented shall be

[573] See *supra* Ch. 4, Part. II, Sec. B.4.
[574] See *supra* Ch. 4, Part. III, Sec. C.2.

responsible for the logistical arrangements for the meetings of the arbitral panel and will provide the administrative personnel necessary for the conduct of the arbitration process. The administrative personnel so provided will report only to the Chair of the arbitration panel concerning any matter related to that process.	responsible for the logistical arrangements for the meetings of the arbitral panel and shall provide the administrative personnel necessary for the conduct of the arbitration process. The administrative personnel so provided will report only to the Chair of the arbitration panel concerning any matter related to that process. Also, unless agreed otherwise by the competent authorities, the venue of arbitration shall be the country of the competent authority which is responsible for the logistical arrangements.
13. Costs Unless agreed otherwise by the competent authorities: *a)* each competent authority and the person who requested the arbitration will bear the costs related to his own participation in the arbitration proceedings (including travel costs and costs related to the preparation and presentation of his views); *b)* each competent authority will bear the remuneration of the arbitrator appointed exclusively by	*9. Costs*[575] Unless agreed otherwise by the competent authorities: (a) Each competent authority and the person who requested the arbitration will bear the costs related to his own participation in the arbitration proceedings (including travel costs and costs related to the preparation and presentation of his views); (b) Each competent authority will bear the remuneration of the arbitrator appointed exclusively

[575] See *supra* Ch. 4, Part. III, Sec. C.3.

that competent authority, or appointed by the Director of the OECD Centre for Tax Policy and Administration because of the failure of that competent authority to appoint that arbitrator, together with that arbitrator's travel, telecommunication and secretariat costs; *c)* the remuneration of the other arbitrators and their travel, telecommunication and secretariat costs will be borne equally by the two Contracting States; *d)* costs related to the meetings of the arbitral panel and to the administrative personnel necessary for the conduct of the arbitration process will be borne by the competent authority to which the case giving rise to the arbitration was initially presented, or if presented in both States, will be shared equally; and *e)* all other costs (including costs of translation and of recording the proceedings) related to expenses that both competent authorities have agreed to incur, will be borne equally by the two Contracting States.	by that competent authority, or appointed by the appointing authority as a result of the competent authority's failure to timely appoint an arbitrator; (c) The remuneration, travel, telecommunication and secretariat costs of the Chair shall be borne equally by the two Contracting States; (d) Costs related to the meetings of the arbitral panel and to the administrative personnel necessary for the conduct of the arbitration process shall be borne by the competent authority to which the case giving rise to the arbitration was initially presented. If such case was initially presented in both States, the foregoing costs shall be shared equally; and (e) All other costs (including costs of translation and of recording the proceedings) related to expenses that both competent authorities have agreed to incur, shall be borne equally by the two Contracting States.
14. Applicable Legal Principles	*10. Applicable Legal Principles*[576]

[576] See *supra* Ch. 4, Part. III, Sec. C.4.

The arbitrators shall decide the issues submitted to arbitration in accordance with the applicable provisions of the treaty and, subject to these provisions, of those of the domestic laws of the Contracting States. Issues of treaty interpretation will be decided by the arbitrators in the light of the principles of interpretation incorporated in Articles 31 to 33 of the *Vienna Convention on the Law of Treaties*, having regard to the Commentaries of the OECD Model Tax Convention as periodically amended, as explained in paragraphs 28 to 36.1 of the Introduction to the OECD Model Tax Convention. Issues related to the application of the arm's length principle should similarly be decided having regard to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. The arbitrators will also consider any other sources which the competent authorities may expressly identify in the Terms of Reference.	In making its determination, the arbitration board shall apply, as necessary and in descending order of priority: (a) the provisions of the Convention; (b) any agreed commentaries or explanations of the Contracting States concerning the Convention; (c) the laws of the Contracting States to the extent they are not inconsistent with each other; and (d) any OECD Commentary, Guidelines or Reports regarding relevant analogous portions of the OECD Model Tax Convention
15. Arbitration decision	*11. Arbitration Decision*[577]

[577] See *supra* Ch. 4, Part. III, Sec. C.5 for discussion on the decision making process of the tribunal and formalities of the arbitral decision.

Where more than one arbitrator has been appointed, the arbitration decision will be determined by a simple majority of the arbitrators. Unless otherwise provided in the Terms of Reference, the decision of the arbitral panel will be presented in writing and shall indicate the sources of law relied upon and the reasoning which led to its result. With the permission of the person who made the request for arbitration and both competent authorities, the decision of the arbitral panel will be made public in redacted form without mentioning the names of the parties involved or any details that might disclose their identity and with the understanding that the decision has no formal precedential value.	(a) Where more than one arbitrator has been appointed, the arbitration decision shall be determined by a simple majority of the arbitrators. (b) The decision of the arbitral panel shall be presented in writing within six months of the appointment of its Chair and shall include the following items: (i) nature of the request with the following information: · name and address of the taxpayer; · the competent authorities involved; · description of the facts and circumstances of the dispute; · a clear statement of what is claimed; (ii) a short summary of the proceedings; (iii) the decision in the form of "Tax assessment made by the competent authority of country A (or B) is hereby cancelled" for double taxation cases, and any other form that is deemed to be appropriate for all other cases; (iv) the sources of law relied upon and the reasoning

	which led to its result opinion; (v) the place where the decision is delivered; (vi) the date of the decision; (vii) the signatures of the arbitrators (c) The arbitral decision is to be implemented as provided for in paragraph 14 of this Rules of Procedure. (d) The competent authorities may agree to publish the decision referred to in this paragraph subject to the consent of the taxpayer and other concerned persons, or may agree not to publish the decision.
16. Time allowed for communicating the arbitration decision The arbitration decision must be communicated to the competent authorities and the person who made the request for arbitration within six months from the date on which the Chair notifies in writing the competent authorities and the person who made the request for arbitration that he has received all the information necessary to begin consideration of the case. Notwithstanding the first part of	*Included in Paragraph 11(b) of Arbitration Decision above.*

this paragraph, if at any time within two months from the date on which the last arbitrator was appointed, the Chair, with the consent of one of the competent authorities, notifies in writing the other competent authority and the person who made the request for arbitration that he has not received all the information necessary to begin consideration of the case, then *a)* if the Chair receives the necessary information within two months after the date on which that notice was sent, the arbitration decision must be communicated to the competent authorities and the person who made the request for arbitration within six months from the date on which the information was received by the Chair, and *b)* if the Chair has not received the necessary information within two months after the date on which that notice was sent, the arbitration decision must, unless the competent authorities agree otherwise, be reached without taking into account that information even if the Chair receives it later and the decision must be communicated to the competent authorities and the person who made the request for	

arbitration within eight months from the date on which the notice was sent.	
17. Failure to communicate the decision within the required period In the event that the decision has not been communicated to the competent authorities within the period provided for in paragraphs 6 *c)* or 16, the competent authorities may agree to extend that period for a period not exceeding six months or, if they fail to do so within one month from the end of the period provided for in paragraphs 6 *c)* or 16, they shall appoint a new arbitrator or arbitrators in accordance with paragraph 5 or 6 *a)*, as the case may be.	*12. Failure to communicate the decision within the required period*[578] In the event that the decision has not been communicated to the competent authorities within the period provided for in paragraphs 11, the competent authorities may agree to extend that period for a period not exceeding three months or, if they fail to do so within one month from the end of the period provided for in paragraphs 14, they shall appoint a new arbitrator or arbitrators in accordance with paragraph 3.
18. Final decision The arbitration decision shall be final, unless that decision is found to be unenforceable by the courts of one of the Contracting States	*13. Final Decision*[579] (a) The arbitration decision rendered pursuant to Article 25 of the Convention and this Rules of Procedure shall be final and shall be implemented in

[578] See *supra* Ch. 4, Part. III, Sec. B.

[579] It was pointed out in Ch. 4., Part III. Sec. D. 3. that the OECD seems to have failed to appreciate the difference between arbitral decisions and mutual agreements in terms of enforceability when drafting Paragraph 18 and 19 as Paragraph 18 and Paragraph 19 of the Sample Agreement seem to conceptually conflict with each other. Suggestion made in this paragraph and the following paragraphs are the result of discussion in Ch. 4., Part III. Sec. D. and Ch. 5.

because of a violation of paragraph 5 of Article 25 or of any procedural rule included in the Terms of Reference or in this agreement that may reasonably have affected the decision. If a decision is found to be unenforceable for one of these reasons, the request for arbitration shall be considered not to have been made and the arbitration process shall be considered not to have taken place (except for the purposes of paragraphs 8 "Communication of information and confidentiality" and 13 "Costs").	accordance with paragraph 14 of this Rules of Procedure. (b) If it is determined that a decision cannot be recognized for one of the reasons listed in Article 25, Paragraph 7 of the Convention, the request for arbitration shall be considered not to have been made and the arbitration process shall be considered not to have taken place (except for the purposes of paragraphs 8 "Communication of information and confidentiality" and 13 "Costs").
19. Implementing the arbitration decision The competent authorities will implement the arbitration decision within six months from the communication of the decision to them by reaching a mutual agreement on the case that led to the arbitration.	*14. Implementing the arbitration decision*[580] (a) The competent authorities shall implement the arbitration decision within three (3) months from the date on which the competent authorities were notified of the decision by reaching a mutual agreement on the case that led to the arbitration. (b) The competent authority against which the arbitral decision is rendered shall take necessary

[580] See generally *supra* Ch. 4, Part. II, Sec. B.

	actions, under the domestic law, to implement such mutual agreement reached within one month from the time mutual agreement is reached. (c) If the competent authority against which the arbitral decision is rendered does not implement the arbitral decision and/or the mutual agreement reached within the time frame mentioned in sub-paragraphs (a) or (b) above, then Article 25, Paragraph 7 of the Convention shall apply.
20. Where no arbitration decision will be provided Notwithstanding paragraphs 6, 15, 16 and 17, where, at any time after a request for arbitration has been made and before the arbitrators have delivered a decision to the competent authorities and the person who made the request for arbitration, the competent authorities notify in writing the arbitrators and that person that they have solved all the unresolved issues described in the Terms of Reference, the case shall be considered as solved under the mutual agreement procedure and no arbitration decision shall be provided. This agreement applies to	

any request for arbitration made pursuant to paragraph 5 of Article 25 of the Convention after that provision has become effective.	
[Date of signature of the agreement]	[Date of signature of the agreement]

APPENDIX II: NEW YORK CONVENTION

CONVENTION ON THE RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS

Article I

1. This Convention shall apply to the recognition and enforcement of arbitral awards made in the territory of a State other than the State where the recognition and enforcement of such awards are sought, and arising out of differences between persons, whether physical or legal. It shall also apply to arbitral awards not considered as domestic awards in the State where their recognition and enforcement are sought.
2. The term “arbitral awards" shall include not only awards made by arbitrators appointed for each case hut also those made by permanent arbitral bodies to which the parties have submitted.
3. When signing, ratifying or acceding to this Convention, or notifying extension under article X hereof, any State may on the basis of reciprocity declare that it will apply the Convention to the recognition and enforcement of awards made only in the territory of another Contracting State. It may also declare that it will apply the Convention only to differences arising out of legal relationships, whether contractual or not, which are considered as commercial under the national law of the State making such declaration.

Article II

1. Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration.
2. The term “agreement in writing" shall include an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams.
3. The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this article, shall, at the request of one of the parties, refer

the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed.

Article III

Each Contracting State shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon, under the conditions laid down in the following articles. There shall not be imposed substantially more onerous conditions or higher fees or charges on the recognition or enforcement of arbitral awards to which this Convention applies than are imposed on the recognition or enforcement of domestic arbitral awards.

Article IV

1. To obtain the recognition and enforcement mentioned in the preceding article, the party applying for recognition and enforcement shall, at the time of the application, supply:
   (a) The duly authenticated original award or a duly certified copy thereof;
   (b) The original agreement referred to in article II or a duly certified copy thereof.
2. If the said award or agreement is not made in an official language of the country in which the award is relied upon, the party applying for recognition and enforcement of the award shall produce a translation of these documents into such language. The translation shall be certified by an official sworn translator or by a diplomatic or consular agent.

Article V

1. Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:
   (a) The parties to the agreement referred to in article 11 were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or

(b) The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or

(c) The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or

(d) The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or

(e) The award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:

   (a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or

   (b) The recognition or enforcement of the award would be contrary to the public policy of that country.

Article VI

If an application for the setting aside or suspension of the award has been made to a competent authority referred to in article V (l) *(e),* the authority before which the award is sought to be relied upon may, if it considers it proper, adjourn the decision on the enforcement of the award and may also, on the application of the party claiming enforcement of the award, order the other party to give suitable security.

Article VII

1. The provisions of present Convention shall not affect the validity of multilateral or bilateral agreements concerning the recognition and

enforcement of arbitral awards entered into by the Contracting States nor deprive any interested party of any right he may have to avail himself of an arbitral award in the manner and to the extent allowed by the law or the treaties of the country where such award is sought to be relied upon.

2. The Geneva Protocol on Arbitration Clauses of 1923 and the Geneva Convention on the Execution of Foreign Arbitral Awards of 1927 shall cease to have effect between Contracting States on their becoming bound and to the extent that they become bound, by this Convention.

Article VIII

1. This Convention shall be open until 31 December 1958 for signature on behalf of any Member of the United Nations and also on behalf of any other State which is or hereafter becomes a member of any specialized agency of the United Nations, or which is or hereafter becomes a party to the Statute of the International Court of Justice, or any other State to which an invitation has been addressed by the General Assembly of the United Nations.
2. This Convention shall be ratified and the instrument of ratification shall be deposited with the Secretary-General of the United Nations.

Article IX

1. This Convention shall be open for accession to all States referred to in article VIII.
2. Accession shall he effected by the deposit of an instrument of accession with the Secretary-General of the United Nations.

Article X

1. Any State may, at the time of signature, ratification or accession, declare that this Convention shall extend to all or any of the territories for the international relations of which it is responsible. Such a declaration shall take effect when the Convention enters into force for the State concerned.
2. At any time thereafter any such extension shall be made by notification addressed to the Secretary-General of the United Nations and shall take effect as from the ninetieth day after the day of receipt by the

Secretary-General of the United Nations of this notification, or as from the date of entry into force of the Convention for the State concerned, whichever is the later.

3. With respect to those territories to which this Convention is not extended at the time of signature, rati6cation or accession, each State concerned shall consider the possibility of taking the necessary steps in order to extend the application of this Convention to such territories, subject, where necessary for constitutional reasons, to the consent of the Governments of such territories.

Article Xl

In the case of a federal or non-unitary State, the following provisions shall apply:

(a) With respect to those articles of this Convention that come within the legislative jurisdiction of the federal authority, the obligations of the federal Government shall to this extent be the same as those of Contracting States which are not federal States;

(b) With respect to those articles of this Convention that come within the legislative jurisdiction of constituent states or provinces which are not, under the constitutional system of the federation, bound to take legislative action, the federal Government shall bring such articles with a favorable recommendation to the notice of the appropriate authorities of constituent states or provinces at the earliest possible moment;

(c) A federal State Party to this Convention shall, at the request of any other Contracting State transmitted through the Secretary-General of the United Nations, supply a statement of the law and practice of the federation and its constituent units in regard to any particular provision of this Convention, showing the extent to which effect has been given to that provision by legislative or other action.

Article XII

1. This Convention shall come into force on the ninetieth day following the date of deposit of the third instrument of ratification or accession.
2. For each State ratifying or acceding to this Convention after the deposit of the third instrument of ratification or accession, this Convention

shall enter into force on the ninetieth day after deposit by such Stale of its instrument f ratification or accession.

Article XIII

1. Any Contracting State may denounce this Convention by a written notification to the Secretary-General of the United Nations. Denunciation shall take effect one year after the date of receipt of the notification by the Secretary-General.
2. Any State which has made a declaration or notification under article X may, at any time thereafter, by notification to the Secretary-General of the United Nations, declare that this Convention shall cease to extend to the territory concerned one year after the date of the receipt of the notification by the Secretary-General.
3. This Convention shall continue to be applicable to arbitral awards in respect of which recognition or enforcement proceedings have been instituted before the denunciation takes effect.

Article XIV

A Contracting State shall not be entitled to avail itself of the present Convention against other Contracting States except to the extent that it is itself bound to apply the Convention.

Article XV

The Secretary-General of the United Nations shall notify the States contemplated in article VIII of the following:

(a) Signatures and ratifications in accordance with article VIII;
(b) Accessions in accordance with article IX;
(c) Declarations and notifications under articles I, X and XI;
(d) The date upon which this Convention enters into force in accordance with article XII;
(e) Denunciations and notifications in accordance with article XIII.

Article XVI

1. This Convention, of which the Chinese, English, French, Russian and Spanish texts shall be equally authentic, shall be deposited in the archives of the United Nations.

2. The Secretary-General of the United Nations shall transmit a certified copy of this Convention to the States contemplated in article VIII.

APPENDIX III: US-GERMANY TAX TREATY, ARTICLE 25, PARAGRAPH 5 AND RELATED PROTOCOL

"5. Where, pursuant to a mutual agreement procedure under this Article, the competent authorities have endeavored but are unable to reach a complete agreement in a case, the case shall be resolved through arbitration conducted in the manner prescribed by, and subject to, the requirements of paragraph 6 and any rules or procedures agreed upon by the Contracting States, if:

a) tax returns have been filed with at least one of the Contracting States with respect to the taxable years at issue in the case;

b) the case

   aa) is a case that

      A) involves the application of one or more Articles that the Contracting States have agreed shall be the subject of arbitration, and

      B) is not a particular case that the competent authorities agree, before the date on which arbitration proceedings would otherwise have begun, is not suitable for determination by arbitration, or

   bb) is a particular case that the competent authorities agree is suitable for determination by arbitration; and

c) all concerned persons agree according to the provisions of subparagraph d) of paragraph 6.

6. For the purposes of paragraph 5 and this paragraph, the following rules and definitions shall apply:

a) The term "concerned person" means the presenter of a case to a competent authority for consideration under this Article and all other persons, if any, whose tax liability to either Contracting State may be directly affected by a mutual agreement arising from that consideration;

b) The "commencement date" for a case is the earliest date on which the information necessary to undertake substantive consideration for a mutual agreement has been received by both competent authorities;

c) Arbitration proceedings in a case shall begin on the later of:

   aa) Two years after the commencement date of that case, unless both competent authorities have previously agreed to a different date,

and

bb) The earliest date upon which the agreement required by subparagraph d) has been received by both competent authorities;

d) The concerned person(s), and their authorized representatives or agents, must agree prior to the beginning of arbitration proceedings not to disclose to any other person any information received during the course of the arbitration proceeding from either Contracting State or the arbitration board, other than the determination of such board;

e) Unless any concerned person does not accept the determination of an arbitration board, the determination shall constitute a resolution by mutual agreement under this Article and shall be binding on both Contracting States with respect to that case; and

f) For purposes of an arbitration proceeding under paragraph 5 and this paragraph, the members of the arbitration board and their staffs shall be considered "persons or authorities" to whom information may be disclosed under Article 26 (Exchange of Information and Administrative Assistance) of the Convention."

2006 Protocol (Article XVI)

22. WITH REFERENCE TO PARAGRAPHS 5 AND 6 OF ARTICLE 25 (MUTUAL AGREEMENT PROCEDURE)

In respect of any case where the competent authorities have endeavored but are unable to reach an agreement under Article 25 regarding the application of one or more of the following Articles of the Convention: 4 (Residence) (but only insofar as it relates to the residence of a natural person), 5 (Permanent Establishment), 7 (Business Profits), 9 (Associated Enterprises), 12 (Royalties), binding arbitration shall be used to determine such application, unless the competent authorities agree that the particular case is not suitable for determination by arbitration. In addition, the competent authorities may, on an ad hoc basis, agree that binding arbitration shall be used in respect of any other matter to which Article 25 applies. If an arbitration proceeding (the Proceeding) under paragraph 5 of Article 25 commences, the following rules and procedures will apply:

a) The Proceeding will be conducted in the manner prescribed by, and subject to the requirements of, paragraphs 5 and 6 of Article 25 and these rules and procedures, as modified or supplemented by any other rules and

procedures agreed upon by the competent authorities pursuant to subparagraph q) below.

b) The determination reached by an arbitration board in the Proceeding shall be limited to a determination regarding the amount of income, expense or tax reportable to the Contracting States.

c) Notwithstanding the initiation of the Proceeding, the competent authorities may reach a mutual agreement to resolve a case and terminate the Proceeding. Correspondingly, a concerned person may withdraw a request for the competent authorities to engage in the Mutual Agreement Procedure (and thereby terminate the Proceeding) at any time.

d) The requirements of subparagraph d) of paragraph 6 of Article 25 will be met when the competent authorities have each received from each concerned person a statement agreeing that the concerned person and each person acting on the concerned person's behalf will not disclose to any other person any information received during the course of the Proceeding from either Contracting State or the Arbitration Board, other than the determination of the Proceeding. A concerned person that has the legal authority to bind any other concerned person(s) on this matter may do so in a comprehensive statement.

e) Each Contracting State will have 60 days from the date on which the Proceeding begins to send a written communication to the other Contracting State appointing one member of the arbitration board. Within 60 days of the date on which the second such communication is sent, the two members appointed by the Contracting States will appoint a third member, who will serve as Chair of the board. If either Contracting State fails to appoint a member, or if the members appointed by the Contracting States fail to agree upon the third member in the manner prescribed by this paragraph, the remaining member(s) will be appointed by the highest-ranking member of the Secretariat at the Centre for Tax Policy and Administration of the Organisation for Economic Co-operation and Development (OECD) who is not a citizen of either Contracting State, by written notice to both Contracting States within 60 days of the date of such failure. The competent authorities will develop a non-exclusive list of individuals with familiarity in international tax matters who may potentially serve as the Chair of the board. In any case, the Chair shall not be a citizen of either Contracting State.

f) The arbitration board may adopt any procedures necessary for the conduct of its business, provided that the procedures are not inconsistent with any provision of Article 25 or the Protocol to the Convention.

g) Each of the Contracting States will be permitted to submit, within 90 days of the appointment of the Chair of the arbitration board, a Proposed Resolution describing the proposed disposition of the specific monetary amounts of income, expense or taxation at issue in the case, and a supporting Position Paper, for consideration by the arbitration board. Copies of the Proposed Resolution and supporting Position Paper shall be provided by the board to the other Contracting State on the date on which the later of the submissions is submitted to the board. In the event that only one Contracting State submits a Proposed Resolution within the allotted time, then that Proposed Resolution shall be deemed to be the determination of the board in that case and the Proceeding shall be terminated. Each of the Contracting States may, if it so desires, submit a Reply Submission to the board within 180 days of the appointment of its Chair, to address any points raised by the Proposed Resolution or Position Paper submitted by the other Contracting State. Additional information may be submitted to the arbitration board only at its request, and copies of the board's request and the Contracting State's response shall be provided to the other Contracting State on the date on which the request or the response is submitted. Except for logistical matters such as those identified in subparagraphs l), n) and o) below, all communications from the Contracting States to the arbitration board, and vice versa, shall take place only through written communications between the designated competent authorities and the Chair of the board.

h) The arbitration board will deliver a determination in writing to the Contracting States within nine months of the appointment of its Chair. The board will adopt as its determination one of the Proposed Resolutions submitted by the Contracting States.

i) In making its determination, the arbitration board will apply, as necessary and in descending order of priority:

aa) the provisions of the Convention;

bb) any agreed commentaries or explanations of the Contracting States concerning the Convention;

cc) the laws of the Contracting States to the extent they are not inconsistent with each other; and

dd) any OECD Commentary, Guidelines or Reports regarding relevant analogous portions of the OECD Model Tax Convention.

j) The determination of the arbitration board in a particular case shall be binding on the Contracting States. The determination of the board will not state a rationale. It will have no precedential value.

k) As provided in subparagraph e) of paragraph 6 of Article 25, the determination of an arbitration board shall constitute a resolution by mutual agreement under Article 25. Each concerned person must, within 30 days of receiving the determination of the board from the competent authority to which the case was first presented, advise that competent authority whether that concerned person accepts the determination of the board. If any concerned person fails to so advise the relevant competent authority within this time frame, the determination of the board will be considered not to have been accepted in that case. Where the determination of the board is not accepted, the case may not subsequently be the subject of a Proceeding.

l) Any meeting(s) of the arbitration board shall be in facilities provided by the Contracting State whose competent authority initiated the mutual agreement proceedings in the case.

m) The treatment of any associated interest or penalties will be determined by applicable domestic law of the Contracting State(s) concerned.

n) No information relating to the Proceeding (including the board's determination) may be disclosed by the members of the arbitration board or their staffs or by either competent authority, except as permitted by the Convention and the domestic laws of the Contracting States. In addition, all material prepared in the course of, or relating to, the Proceeding shall be considered to be information exchanged between the Contracting States. All members of the arbitration board and their staffs must agree in statements sent to each of the Contracting States in confirmation of their appointment to the arbitration board to abide by and be subject to the confidentiality and nondisclosure provisions of Article 26 (Exchange of Information and Administrative Assistance) of the Convention and the applicable domestic laws of the Contracting States. In the event those provisions conflict, the most restrictive condition shall apply.

o) The fees and expenses will be borne equally by the Contracting States. In general, the fees of members of the arbitration board will be set at the fixed amount of $2,000 (two thousand United States dollars) per day or the equivalent amount in euro, subject to modification by the competent authorities. In general, the expenses of members of the arbitration board will be set in accordance with the International Centre for Settlement of Investment Disputes (ICSID) Schedule of Fees for arbitrators (as in effect on the date on which the arbitration proceedings begin), subject to modification by the competent authorities. Any fees for language translation will also be borne equally by the Contracting States. Meeting facilities, related resources, financial management, other logistical support, and general administrative coordination of the Proceeding will be provided, at its own cost, by the Contracting State whose competent authority initiated the mutual agreement proceedings in the case. Any other costs shall be borne by the Contracting State that incurs them.

q) The competent authorities of the Contracting States may modify or supplement the above rules and procedures as necessary to more effectively implement the intent of paragraph 5 of Article 25 to eliminate double taxation.

APPENDIX IV: EU TRANSFER PRICING ARBITRATION CONVENTION AND CODE OF PROCEDURE

CHAPTER I

SCOPE OF THE CONVENTION

Article 1

1. This Convention shall apply where, for the purposes of taxation, profits which are included in the profits of an enterprise of a Contracting State are also included or are also likely to be included in the profits of an enterprise of another Contracting State on the grounds that the principles set out in Article 4 and applied either directly or in corresponding provisions of the law of the State concerned have not been observed.
2. For the purposes of this Convention, the permanent establishment of an enterprise of an Contracting State situated in another Contracting State shall be deemed to be an enterprise of the State in which it is situated.
3. Paragraph 1 shall also apply where any of the enterprises concerned have made losses rather than profits.

Article 2

1. This Convention shall apply to taxes on income.
2. The existing taxes to which this Convention shall apply are, in particular the following:

   (a) in Belgium:
   - impôt des personnes physiques/personenbelasting,
   - impôt des sociétés/vennootschapsbelasting,
   - impôt des personnes morales/rechtspersonenbelasting,
   - impôt des non-résidents/belasting der niet-verblijfhouders,
   - taxe communale et la taxe d'agglomération additionnelles à l'impôt des personnes physiques/aanvullende gemeentebelasting en agglomeratiebelasting op de personenbelasting;

   (b) in Denmark:
   - selskabsskat,
   - indkomstskat til staten,
   - kommunale indkomstskat,
   - amtskommunal indkomstskat,
   - saerlig indkomstskat,
   - kirkeskat,
   - udbytteskat,

- renteskat,
- royaltyskat,
- frigoerelsesafgift;

(c) in the Federal Republic of Germany:

- Einkommensteuer,
- Koerperschaftsteuer,
- Gewerbesteuer, in so far as this tax is based on trading profits;

(d) in Greece:

- foros eisodimatos fysikon prosopon,
- foros eisodimatos nomikon prosopon,
- eisfora yper ton epicheiriseon ydrefsis kai apochetefsis;

(e) in Spain:

- impuesto sobre la renta de las personas fisicas,
- impuesto sobre sociedades;

(f) in France:

- impôt sur le revenu,
- impôt sur les sociétés;

(g) in Ireland:

- Income Tax,
- Corporation Tax;

(h) in Italy:

- imposta sul reddito delle persone fisiche,
- imposta sul reddito delle persone giuridiche,
- imposta locale sui redditi;

(i) in Luxembourg:

- impôt sur le revenu des personnes physiques,
- impôt sur le revenu des collectivités,
- impôt commercial, in so far as this tax is based on trading profits;

(j) in the Netherlands:

- inkomstenbelasting,
- vennootschapsbelasting;

(k) in Portugal:

- imposto sobre o rendimento das pessoas singulares,
- imposto sobre o rendimento das pessoas colectivas,
- derrama para os municípios sobre o imposto sobre o rendimento das pessoas colectivas;

(l) in the United Kingdom:

- Income Tax,

- Corporation Tax.

3. The Convention shall also apply to any identical or similar taxes which are imposed after the date of signature thereof in addition to, or in place of existing taxes. The competent authorities of the Contracting States shall inform each other of any changes made in the respective domestic laws.

CHAPTER II
GENERAL PROVISIONS

Section I
Definitions
Article 3

1. For the purposes of this Convention: 'competent authority' shall mean:

- in Belgium:
  De Minister van Financiën or an authorized representative,
  Le Ministre des Finances or an authorized representative,
- in Denmark:
  Skatteministeren or an authorized representative,
- in the Federal Republic of Germany:
  Der Bundesminister der Finanzen or an authorized representative,
- in Greece:
  Ypoyrgos ton Oikonomikon or an authorized representative,
- in Spain:
  El Ministro de Economía y Hacienda or an authorized representative,
- in France:
  Le Ministre chargé du budget or an authorized representative,
- in Ireland:
  The Revenue Commissioners or an authorized representative,
- in Italy:
  Il Ministro delle Finanze or an authorized representative,
- in Luxembourg:
  Le Ministre des Finances or an authorized representative,
- in the Netherlands:
  De Minister van Financiën or an authorized representative,
- in Portugal:
  Ministro das Finanças or an authorized representative,
- in the United Kingdom:

The Commissioners of Inland Revenue or an authorized representative.

2. Any term not defined in this Convention shall, unless the context otherwise requires, have the meaning which it has under the double taxation convention between the States concerned.

Section II

Principles applying to the adjustment of profits of associated enterprises and to the attribution of profits to permanent establishments

Article 4

The following principles shall be observed in the application of this Convention:

1. Where:
   (a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of another Contracting State, or
   (b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of one Contracting State and an enterprise of another Contracting State,

   and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.
2. Where an enterprise of a Contracting State carries on business in another Contracting State through a permanent establishment situated therein, there shall be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

Article 5

Where a Contracting State intends to adjust the profits of an enterprise in accordance with the principles set out in Article 4, it shall inform the enterprise of the intended action in due time and give it the opportunity to inform the other enterprise so as to give that other enterprise the opportunity to inform in turn the other Contracting State.

However, the Contracting State providing such information shall not be prevented from making the proposed adjustment.

If after such information has been given the two enterprises and the other Contracting State agree to the adjustment, Articles 6 and 7 shall not apply.

Section 3
Mutual agreement and arbitration procedure
Article 6

1. Where an enterprise considers that, in any case to which this Convention applies, the principles set out in Article 4 have not been observed, it may, irrespective of the remedies provided by the domestic law of the Contracting States concerned, present its case to the competent authority of the Contracting State of which it is an enterprise or in which its permanent establishment is situated. The case must be presented within three years of the first notification of the action which results or is likely to result in double taxation within the meaning of Article 1. The enterprise shall at the same time notify the competent authority if other Contracting States may be concerned in the case. The competent authority shall then without delay notify the competent authorities of those other Contracting States.
2. If the complaint appears to it to be well-founded and if it is not itself able to arrive at a satisfactory solution, the competent authority shall endeavour to resolve the case by mutual agreement with the competent authority of any other Contracting State concerned, with a view to the elimination of double taxation on the basis of the principles set out in Article 4. Any mutual agreement reached shall be implemented irrespective of any time limits prescribed by the domestic laws of the Contracting States concerned.

Article 7

1. If the competent authorities concerned fail to reach an agreement that eliminates the double taxation referred to in Article 6 within two years of the date on which the case was first submitted to one of the competent authorities in accordance with Article 6 (1), they shall set up an advisory commission charged with delivering its opinion on the elimination of the double taxation in question. Enterprises may have recourse to the remedies available to them under the domestic law of the Contracting States concerned; however, where the case has so been submitted to a court or tribunal, the term of two years referred to in the first subparagraph shall be computed from the date on which the judgment of the final court of appeal was given.

2. The submission of the case to the advisory commission shall not prevent a Contracting State from initiating or continuing judicial proceedings or proceedings for administrative penalties in relation to the same matters.
3. Where the domestic law of a Contracting State does not permit the competent authorities of that State to derogate from the decisions of their judicial bodies, paragraph 1 shall not apply unless the associated enterprise of that State has allowed the time provided for appeal to expire, or has withdrawn any such appeal before a decision has been delivered. This provision shall not affect the appeal if and in so far as it relates to matters other than those referred to in Article 6.
4. The competent authorities may by mutual agreement and with the agreement of the associated enterprises concerned waive the time limits referred to in paragraph 1.
5. In so far as the provisions of paragraphs 1 to 4 are not applied, the rights of each of the associated enterprises, as laid down in Article 6, shall be unaffected.

Article 8

1. The competent authority of a Contracting State shall not be obliged to initiate the mutual agreement procedure or to set up the advisory commission referred to in Article 7 where legal or administrative proceedings have resulted in a final ruling that by actions giving rise to an adjustment of transfers of profits under Article 4 one of the enterprises concerned is liable to a serious penalty.
2. Where judicial or administrative proceedings, initiated with a view to a ruling that by actions giving rise to an adjustment of profits under Article 4 one of the enterprises concerned was liable to a serious penalty, are being conducted simultaneously with any of the proceedings referred to in Articles 6 and 7, the competent authorities may stay the latter proceedings until the judicial or administrative proceedings have been concluded.

Article 9

1. The advisory commission referred to in Article 7 (1) shall consist of, in addition to its Chairman:
   - two representatives of each competent authority concerned; this number may be reduced to one by agreement between the competent authorities,
   - an even number of independent persons of standing to be appointed by mutual agreement from the list of persons referred to in

paragraph 4 or, in the absence of agreement, by the drawing of lots by the competent authorities concerned.

2. When the independent persons of standing are appointed an alternate shall be appointed for each of them according to the rules for the appointment of the independent persons in case the independent persons are prevented from carrying out their duties.
3. Where lots are drawn, each of the competent authorities may object to the appointment of any particular independent person of standing in any circumstance agreed in advance between the competent authorities concerned or in one of the following situations:
   - where that person belongs to or is working on behalf of one of the tax administrations concerned,
   - where that person has, or has had, a large holding in or is or has been an employee of or adviser to one or each of the associated enterprises,
   - where that person does not offer a sufficient guarantee of objectivity for the settlement of the case or cases to be decided.
4. The list of independent persons of standing shall consist of all the independent persons nominated by the Contracting States. For this purpose each Contracting State shall nominate five persons and shall inform the Secretary-General of the Council of the European Communities thereof. Such persons must be nationals of a Contracting State and resident within the territory to which this Convention applies. They must be competent and independent. The Contracting States may make alterations to the list referred to in the first subparagraph; they shall inform the Secretary-General of the Council of the European Communities thereof without delay.
5. The representatives and independent persons of standing appointed in accordance with paragraph 1 shall elect a Chairman from among those persons of standing on the list referred to in paragraph 4, without prejudice to the right of each competent authority concerned to object to the appointment of the person of standing thus chosen in one of the situations referred to in paragraph 3. The Chairman must possess the qualifications required for appointment to the highest judicial offices in his country or be a jurisconsult of recognized competence.
6. The members of the advisory commission shall keep secret all matters which they learn as a result of the proceedings. The Contracting States shall adopt appropriate provisions to penalize any breach of secrecy obligations. They shall, without delay inform the Commission of the

European Communities of the measures taken. The Commission of the European Comunities shall inform the other Contracting States.

7. The Contracting States shall take all necessary steps to ensure that the advisory commission meets without delay once cases are referred to it.

Article 10

1. For the purposes of the procedure referred to in Article 7, the associated enterprises concerned may provide any information, evidence or documents which seem to them likely to be of use to the advisory commission in reaching a decision. The enterprises and the competent authorities of the Contracting States concerned shall give effect to any request made by the advisory commission to provide information, evidence or documents. However, the competent authorities of any such Contracting State shall not be under any obligation:
   (a) to carry out administrative measures at variance with its domestic law or its normal administrative practice;
   (b) to supply information which is not obtainable under its domestic law or in its normal administrative practice; or
   (c) to supply information which would disclose any trade, business, industrial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (ordre public).
2. Each of the associated enterprises may, at its request, appear or be represented before the advisory commission. If the advisory commission so requests, each of the associated enterprises shall appear or be represented before it.

Article 11

1. The advisory commission referred to in Article 7 shall deliver its opinion not more than six months from the date on which the matter was referred to it. The advisory commission must base its opinion on Article 4.
2. The advisory commission shall adopt its opinion by a simple majority of its members. The competent authorities concerned may agree on additional rules of procedure.
3. The costs of the advisory commission procedure, other than those incurred by the associated enterprises, shall be shared equally by the Contracting States concerned.

Article 12

1. The competent authorities party to the procedure referred to in Article 7 shall, acting by common consent on the basis of Article 4, take a decision which will eliminate the double taxation within six months of the date on which the advisory commission delivered its opinion. The competent authorities may take a decision which deviates from the advisory commission's opinion. If they fail to reach agreement, they shall be obliged to act in accordance with that opinion.
2. The competent authorities may agree to publish the decision referred to in paragraph 1, subject to the consent of the enterprises concerned.

Article 13

The fact that the decisions taken by the Contracting States, concerning the taxation of profits resulting from a transaction between associated enterprises, have become final shall not prevent recourse to the procedures set out in Articles 6 and 7.

Article 14

For the purposes of this Convention, the double taxation of profits shall be regarded as eliminated if either:

(a) the profits are included in the computation of taxable profits in one State only; or
(b) the tax chargeable on those profits in one State is reduced by an amount equal to the tax chargeable on them in the other.

CHAPTER III

FINAL PROVISIONS

Article 15

Nothing in this Convention shall affect the fulfillment of wider obligations with respect to the elimination of double taxation in the case of an adjustment of profits of associated enterprises resulting either from other conventions to which the Contracting States are or will become parties or from the domestic law of the Contracting States.

Article 16

1. The territorial scope of this Convention shall be that defined in Article 227 (1) of the Treaty establishing the European Economic Community, without prejudice to paragraph 2 of this Article.
2. This Convention shall not apply to:
   - the French territories referred to in Annex IV to the Treaty establishing the European Economic Community,

- the Faroe Islands and Greenland.

Article 17

This Convention will be ratified by the Contracting States. The instruments of ratification will be deposited at the office of the Secretary-General of the Council of the European Communities.

Article 18

This Convention shall enter into force on the first day of the third month following that in which the instrument of ratification is deposited by the last signatory State to take that step. The Convention shall apply to proceedings referred to in Article 6 (1) which are initiated after its entry into force.

Article 19

The Secretary-General of the Council of the European Communities shall inform the Contracting States of:

(a) the deposit of each instrument of ratification;
(b) the date on which this Convention will enter into force;
(c) the list of independent persons of standing appointed by the Contracting States and any alterations thereto in accordance with Article 9 (4).

Article 20

This Convention is concluded for a period of five years. Six months before the expiry of that period, the Contracting

States will meet to decide on the extension of this Convention and any other relevant measure.

Article 21

Each Contracting State may, at any time, ask for a revision of this Convention. In that event, a conference to revise the Convention will be convened by the President of the Council of the European Communities.

Article 22

This Convention, drawn up in a single original in the Danish, Dutch, English, French, German, Greek, Irish, Italian, Portuguese and Spanish languages, all 10 texts being equally authentic, shall be deposited in the archives of the General Secretariat of the Council of the European Communities. The Secretary-General shall transmit a certified copy to the Government of each Signatory State.

FINAL ACT

THE PLENIPOTENTIARIES OF THE HIGH CONTRACTING PARTIES,

meeting at Brussels, on the twenty-third day of July nineteen hundred and ninety, for the signature of the Convention on the elimination of double taxation

in connection with the adjustment of profits of associated enterprises, have, on the occasion of signing the said Convention:

(a) adopted the following joint Declarations attached to the Final Act:

- Declaration on Article 4 (1),
- Declaration on Article 9 (6),
- Declaration on Article 13;

(b) taken note of the following unilateral Declarations attached to this Final Act:

- Declaration of France and the United Kingdom on Article 7,
- Individual Declarations of the Contracting States on Article 8,
- Declaration of the Federal Republic of Germany on Article 16.

En fe de lo cual, los abajo firmantes suscriben la presente Acta Final.
Til bekraeftelse heraf har undertegnede underskrevet denne slutakt.
Zu Urkund dessen haben die Unterzeichneten ihre Unterschrift unter diese Schlussakte gesetzt.
Se pistosi ton anotero, oi ypografontes plirexoysioi ethesan tin ypografi toys kato apo tin paroysa teliki praxi.
In witness whereof, the undersigned have signed this Final Act.
En foi de quoi, les soussignés ont apposé leurs signatures au bas du présent acte final.
Dá fhianú sin, chuir na daoine thíos-sínithe a lámh leis an Ionstraim Chríochnaitheach seo.
In fede di che, i sottoscritti hanno apposto le loro firme in calce al presente atto finale.
Ten blijke waarvan de ondergetekenden hun handtekening onder deze Slotakte hebben gesteld.
Em fé do que os abaixo assinados apuseram as suas assinaturas no final do presente Acto Final.
Hecho en Bruselas, el veintitrés de julio de mil novecientos noventa.
Udfaerdiget i Bruxelles, den treogtyvende juli nitten hundrede og halvfems.
Geschehen zu Bruessel am dreiundzwanzigsten Juli neunzehnhundertneunzig.
iEgine stis Vryxelles, stis eikosi treis Ioylioy chilia enniakosia eneninta.
Done at Brussels on the twenty-third day of July in the year one thousand nine hundred and ninety.
Fait à Bruxelles, le vingt-trois juillet mil neuf cent quatre-vingt-dix.
Arna dhéanamh sa Bhruiséil, an tríú lá fichead de Iúil, míle naoi gcéad nócha.
Fatto a Bruxelles, addì ventitré luglio millenovecentonovanta.
Gedaan te Brussel, de drieëntwintigste juli negentienhonderd negentig.
Feito em Bruxelas, em vinte e três de Julho de mil novecentos e noventa.

Pour Sa Majesté le Roi des Belges
Voor Zijne Majesteit de Koning der Belgen
For Hendes Majestaet Danmarks Dronning
Fuer den Praesidenten der Bundesrepublik Deutschland
Gia ton Proedro tis Ellinikis Dimokratias
Por Su Majestad el Rey de España
Pour le président de la République française
For the President of Ireland
Thar ceann Uachtarán na hÉireann
Per il presidente della Repubblica italiana
Pour Son Altesse Royale le Grand-Duc de Luxembourg
Voor Hare Majesteit de Koningin der Nederlanden
Pelo Presidente da República Portuguesa
For Her Majesty the Queen of the United Kingdom of Great Britain and Northern Ireland

JOINT DECLARATIONS

Declaration on Article 4 (1)

The provisions of Article 4 (1) shall cover both cases where a transaction is carried out directly between two legally distinct enterprises as well as cases where a transaction is carried out between one of the enterprises and the permanent establishment of the other enterprise situated in a third country.

Declaration on Article 9 (6)

The Member States shall be entirely free as regards the nature and scope of the appropriate provisions they adopt for penalizing any breach of secrecy obligations.

Declaration on Article 13

Where, in one or more of the Contracting States concerned, the decisions regarding the taxation giving rise to the procedures referred to in Articles 6 and 7 have been altered after the procedure referred to in Article 6 has been concluded or after the decision referred to in Article 12 has been taken and where double taxation within the meaning of Article 1 results, account being taken of the application of the outcome of that procedure or that decision, Articles 6 and 7 shall apply.

UNILATERAL DECLARATIONS

Declaration on Article 7

France and the United Kingdom declare that they will apply Article 7 (3).

Individual Declarations of the Contracting States on Article 8

Belgium

The term 'serious penalty' means a criminal or administrative penalty in cases:

- either of a common law offence committed with the aim of tax evasion,
- or infringements of the provisions of the Code of income tax or of decisions taken in implementation thereof, committed with fraudulent intention or with the intention of causing injury.

Denmark

The concept of 'serious penalty' means a penalty for the intentional infringement of provisions of the Criminal Law or of special legislation in cases which cannot be regulated by administrative means.

Cases of infringement of provisions of tax law may, as a general rule, be regulated by administrative means where it is considered that the infringement will not entail a punishment greater than a fine.

Germany

An infringement of the tax laws punishable by a 'serious penalty' is constituted by any infringement of the tax laws penalized by detention, criminal or administrative fines.

Greece

Under Greek legislation governing taxation, an undertaking is liable to 'severe penalties':

1. if it fails to submit declarations, or submits incorrect declarations, in respect of taxes, charges or contributions which must be withheld and paid to the State under existing provisions, or in respect of value added tax, turnover tax or the special tax on luxury goods, in so far as the total amount of the above taxes, charges and contributions which should have been declared and paid to the State as a result of trade or other activities carried out over a period of six months exceeds an amount of six hundred thousand (600 000) Greek drachmas or one million (1 000 000) Greek drachmas over a period of one calendar year;
2. if it fails to submit a declaration of income tax, in so far as the tax due in respect of the income not declared is more than three hundred thousand (300 000) Greek drachmas;
3. if it fails to supply the taxation details laid down in the Code on Taxation Data;
4. if it supplies details as referred to under the previous case 3, which are incorrect as regards quantity or unit price or value, in so far as the inaccuracy results in a discrepancy which exceeds ten per cent

(10 %) of the total amount or of the total value of the goods, the provision of services or the trade generally;

5. if it fails to keep accurately the books and records required by the Code on Taxation Data, in so far as that inaccuracy has been noted in the course of a regular check, the findings of which have been confirmed either by administrative resolution of the discrepancy or because the period allowed for an appeal has expired or as a result of a definitive decision by an administrative tribunal, provided that during the management period checked the discrepancy between gross income and the income declared is more than twenty per cent (20 %) and in any case not less than one million (1 000 000) Greek drachmas;
6. if it fails to observe the obligation to keep books and records as laid down in the relevant provisions of the Code on Taxation Data;
7. if it issues false or fictitious - or itself falsifies - invoices for the sale of goods or the supply of services or any other taxation details as referred to in case 3 above.
8. A taxation document is regarded as false if it has been perforated or stamped in any way without the proper authentication having been entered in the relevant books of the competent tax authority, in so far as failure to make such an entry has occurred in the knowledge that such authentication is required for the taxation document. A taxation document is also regarded as false if the content and other details of the original or the copy differ from those which are recorded on the counterfoil of that document.
9. A taxation document is regarded as fictitious if it has been issued for a transaction or part of a transaction, transfer or any other reason not recorded in the total or for a transaction carried out by persons different from those recorded in the taxation document;
10. if it is aware of the intention of the action taken and collaborates in any way in the production of false taxation documents or is aware that the documents are false or fictitious and collaborates in any way in their issue or accepts the false, fictitious or falsified taxation documents with the intention of concealing material relevant to taxation.

Spain

The term 'serious penalties' includes administrative penalties for serious tax infringements, as well as criminal penalties for offences committed with respect to the taxation authorities.

France

The term 'serious penalties' includes criminal penalties and tax penalties such as penalties for failure to make a tax return after receiving a summons, for lack of good faith, for fraudulent practices, for opposition to tax inspection, for secret payments or distribution, or for abuse of rights.

Ireland

'Serious penalties' shall include penalties for:

(a) failing to make a return;
(b) fraudulently or negligently making an incorrect return;
(c) failing to keep proper records;
(d) failing to make documents and records available for inspection;
(e) obstructing persons exercising statutory powers;
(f) failing to notify chargeability to tax;
(g) making a false statement to obtain an allowance.

The legislative provisions governing these offences, as at 3 July 1990, are as follows:

- Part XXXV of the Income Tax Act, 1967,
- Section 6 of the Finance Act, 1968,
- Part XIV of the Corporation Tax Act, 1976,
- Section 94 of the Finance Act, 1983.

Any subsequent provisions replacing, amending or updating the penalty code would also be comprehended.

Italy

The term 'serious penalties' means penalties laid down for illicit acts, within the meaning of the domestic law, constituting a tax offence.

Luxembourg

Luxembourg considers to be a 'serious penalty' what the other Contracting State considers to be so for the purposes of Article 8.

Netherlands

The term 'serious penalty' means a penalty imposed by a judge for any action, committed intentionally, which is mentioned in Article 68 of the General Law on taxation.

Portugal

The terms 'serious penalties' include criminal penalties as well as the further tax penalties applicable to infringements committed with intent to defraud or in which the fine applicable is of an amount exceeding 1 000 000 (one million) Portuguese escudos.

United Kingdom

The United Kingdom will interpret the term 'serious penalty' as comprising criminal sanctions and administrative sanctions in respect of the fraudulent or negligent delivery of incorrect accounts, claims or returns for tax purposes.

Declaration by the Federal Republic of Germany on Article 16

The Government of the Federal Republic of Germany reserves the right to declare, when lodging its instrument of ratification that the Convention also applies to Land of Berlin.

Code of Conduct

Revised Code of Conduct for the effective implementation of the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises

2009/C 322/01

THE COUNCIL OF THE EUROPEAN UNION AND THE REPRESENTATIVES OF THE GOVERNMENTS OF THE MEMBER STATES, MEETING WITHIN THE COUNCIL, HAVING REGARD to the Convention of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (the "Arbitration Convention"), ACKNOWLEDGING the need both for Member States, as Contracting States to the Arbitration Convention, and for taxpayers to have more detailed rules to implement efficiently the Arbitration Convention, NOTING the Commission Communication of 14 September 2009 on the work of the EU Joint Transfer Pricing Forum (JTPF) in the period March 2007 to March 2009, based on the reports of the JTPF on penalties and transfer pricing, and on the interpretation of some provisions of the Arbitration Convention, EMPHASISING that this Code of Conduct is a political commitment and does not affect the Member States' rights and obligations or the respective spheres of competence of the Member States and the European Union resulting from the Treaty on European Union and the Treaty on the Functioning of the European Union, ACKNOWLEDGING that the implementation of this Code of Conduct should not hamper solutions at a more global level, TAKING NOTE of the conclusions of the JTPF report on penalties, HEREBY ADOPT THE FOLLOWING REVISED CODE OF CONDUCT:

Without prejudice to the respective spheres of competence of the Member States and the European Union, this revised Code of Conduct concerns the implementation of the Arbitration Convention and certain related issues

concerning mutual agreement procedures under double taxation treaties between Member States.

1. Scope of the Arbitration Convention

1.1. EU triangular transfer pricing cases

(a) For the purpose of this Code of Conduct, a EU triangular case is a case where, in the first stage of the Arbitration Convention procedure, two EU competent authorities cannot fully resolve any double taxation arising in a transfer pricing case when applying the arm's length principle because an associated enterprise situated in (an)other Member State(s) and identified by both EU competent authorities (evidence based on a comparability analysis including a functional analysis and other related factual elements) had a significant influence in contributing to a non-arm's length result in a chain of relevant transactions or commercial/financial relations and is recognised as such by the taxpayer suffering the double taxation and having requested the application of the provisions of the Arbitration Convention.

(b) The scope of the Arbitration Convention includes all EU transactions involved in triangular cases among Member States.

1.2. Thin capitalisation [1]

The Arbitration Convention makes clear reference to profits arising from commercial and financial relations but does not seek to differentiate between these specific profit types. Therefore, profit adjustments arising from financial relations, including a loan and its terms, and based on the arm's length principle are to be considered within the scope of the Arbitration Convention.

2. Admissibility of a case

On the basis of Article 18 of the Arbitration Convention, Member States are recommended to consider that a case is covered by the Arbitration Convention when the request is presented in due time after the date of entry into force of accession by new Member States to the Arbitration Convention, even if the adjustment applies to earlier fiscal years.

3. Serious penalties

As Article 8(1) provides for flexibility in refusing to give access to the Arbitration Convention due to the imposition of a serious penalty, and considering the practical experience acquired since 1995, Member States are recommended to clarify or revise their unilateral declarations in the Annex to the Arbitration Convention in order to better reflect that a serious penalty should only be applied in exceptional cases like fraud.

4. The starting point of the three-year period (deadline for submitting the request according to Article 6(1) of the Arbitration Convention)

The date of the "first tax assessment notice or equivalent which results or is likely to result in double taxation within the meaning of Article 1 of the Arbitration Convention, e.g. due to a transfer pricing adjustment" [2], is considered as the starting point for the three-year period.

As far as transfer pricing cases are concerned, Member States are recommended to apply this definition also to the determination of the three-year period as provided for in Article 25.1 of the OECD Model Tax Convention on Income and on Capital and implemented in the double taxation treaties between Member States.

5. The starting point of the two-year period (Article 7(1) of the Arbitration Convention)

(a) For the purpose of Article 7(1) of the Arbitration Convention, a case will be regarded as having been submitted according to Article 6(1) when the taxpayer provides the following:

(i) identification (such as name, address, tax identification number) of the enterprise of the Member State that presents its request and of the other parties to the relevant transactions;

(ii) details of the relevant facts and circumstances of the case (including details of the relations between the enterprise and the other parties to the relevant transactions);

(iii) identification of the tax periods concerned;

(iv) copies of the tax assessment notices, tax audit report or equivalent leading to the alleged double taxation;

(v) details of any appeals and litigation procedures initiated by the enterprise or the other parties to the relevant transactions and any court decisions concerning the case;

(vi) an explanation by the enterprise of why it considers that the principles set out in Article 4 of the Arbitration Convention have not been observed;

(vii) an undertaking that the enterprise shall respond as completely and quickly as possible to all reasonable and appropriate requests made by a competent authority and have documentation at the disposal of the competent authorities; and

(viii) any specific additional information requested by the competent authority within two months upon receipt of the taxpayer's request.

(b) The two-year period starts on the latest of the following dates:

(i) the date of the tax assessment notice, i.e., a final decision of the tax administration on the additional income, or equivalent;

(ii) the date on which the competent authority receives the request and the minimum information as stated under point (a).

6. Mutual agreement procedures under the Arbitration Convention

6.1. General provisions

(a) The arm's length principle will be applied, as advocated by the OECD, without regard to the immediate tax consequences for any particular Member State.

(b) Cases will be resolved as quickly as possible having regard to the complexity of the issues in the particular case in question.

(c) Any appropriate means for reaching a mutual agreement as expeditiously as possible, including face-to-face meetings, will be considered. Where appropriate, the enterprise will be invited to make a presentation to its competent authority.

(d) Taking into account the provisions of this Code of Conduct, a mutual agreement should be reached within two years of the date on which the case was first submitted to one of the competent authorities in accordance with point 5(b) of this Code of Conduct. However, it is recognised that in some situations (e.g. imminent resolution of the case or particularly complex transactions, or triangular cases), it may be appropriate to apply Article 7(4) of the Arbitration Convention (providing for time limits to be extended) to agree a short extension.

(e) The mutual agreement procedure should not impose any inappropriate or excessive compliance costs on the person requesting it, or on any other person involved in the case.

6.2. EU triangular transfer pricing cases

(a) As soon as the competent authorities of the Member States have agreed that the case under discussion is to be considered a EU triangular case, they should immediately invite the other EU competent authority(ies) to take part in the proceedings and discussions as (an) observer(s) or as (an) active stakeholder(s) and decide together which is their favoured approach. Accordingly, all information should be shared with the other EU competent authority(ies) through for example exchanges of information. The other competent authority(ies) should be invited to acknowledge the actual or possible involvement of "their" taxpayer(s).

(b) One of the following approaches may be adopted by the competent authorities involved to resolve double taxation arising from EU triangular cases under the Arbitration Convention:

(i) the competent authorities can decide to take a multilateral approach (immediate and full participation of all the competent authorities concerned); or

(ii) the competent authorities can decide to start a bilateral procedure, whereby the two parties to the bilateral procedure are the competent authorities that identified (based on a comparability analysis including a functional analysis and other related factual elements) the associated enterprise situated in another Member State that had a significant influence in contributing to a non-arm's length result in the chain of relevant transactions or commercial/financial relations, and should invite the other EU competent authority(ies) to participate as (an) observer(s) in the mutual agreement procedure discussions; or

(iii) the competent authorities can decide to start more than one bilateral procedure in parallel and should invite the other EU competent authority(ies) to participate as (an) observer(s) in the respective mutual agreement procedure discussions.

(iv) Member States are recommended to apply a multilateral procedure to resolve such double taxation cases. However this should always be agreed by all the competent authorities, based on the specific facts and circumstances of the case. If a multilateral approach is not possible and a two or more parallel bilateral procedures are started, all relevant competent authorities should be involved in the first stage of the Arbitration Convention procedure either as Contracting States in the initial Arbitration Convention application or as observers.

(c) The status of observer may change to that of stakeholder depending on the development of the discussions and evidence presented. If the other competent authority(ies) want(s) to participate in the second stage (arbitration), it (they) has (have) to become (a) stakeholder(s). The fact that the other EU competent authority(ies) remain(s) throughout as (a) party(ies) to the discussions as (an) observer(s) only has no consequences for the application of the provisions of the Arbitration Convention (e.g. timing issues and procedural issues). Participation as (an) observer(s) does not bind the other competent authority(ies) to the final outcome of the Arbitration Convention procedure. In the procedure, any exchange of information must comply with the normal legal and administrative requirements and procedures.

(d) The taxpayer(s) should, as soon as possible, inform the tax administration(s) involved that (an) other party(ies), in (an)other Member State(s), could be involved in the case. That notification should be followed in a timely manner by the presentation of all relevant facts and supporting documentation. Such an approach will not only lead to quicker resolution but also guard against the failure to resolve double taxation issues due to differing procedural deadlines in the Member States.

6.3. Practical functioning and transparency

(a) In order to minimise costs and delays caused by translation, the mutual agreement procedure, in particular the exchange of position papers, should be conducted in a common working language, or in a manner having the same effect, if the competent authorities can reach agreement on a bilateral (or multilateral) basis.

(b) The enterprise requesting the mutual agreement procedure will be kept informed by the competent authority to which it made the request of all significant developments that affect it during the course of the procedure.

(c) The confidentiality of information relating to any person that is protected under a bilateral tax convention or under the law of a Member State will be ensured.

(d) The competent authority will acknowledge receipt of a taxpayer's request to initiate a mutual agreement procedure within one month from the receipt of the request and at the same time inform the competent authority(ies) of the other Member State(s) involved in the case attaching a copy of the taxpayer's request.

(e) If the competent authority believes that the enterprise has not submitted the minimum information necessary for the initiation of a mutual agreement procedure as stated under point 5(a), it will invite the enterprise, within two months upon receipt of the request, to provide it with the specific additional information it needs.

(f) Member States undertake that the competent authority will respond to the enterprise making the request in one of the following forms:

(i) if the competent authority does not believe that profits of the enterprise are included, or are likely to be included, in the profits of an enterprise of another Member State, it will inform the enterprise of its doubts and invite it to make any further comments;

(ii) if the request appears to the competent authority to be well-founded and it can itself arrive at a satisfactory solution, it will inform the

enterprise accordingly and make as quickly as possible such adjustments or allow such reliefs as are justified;

(iii) if the request appears to the competent authority to be well-founded but it is not itself able to arrive at a satisfactory solution, it will inform the enterprise that it will endeavour to resolve the case by mutual agreement with the competent authority of any other Member State concerned.

(g) If a competent authority considers a case to be well-founded, it should initiate a mutual agreement procedure by informing the competent authority(ies) of the other Member State(s) of its decision and attach a copy of the information as specified under point 5(a) of this Code of Conduct. At the same time it will inform the person invoking the Arbitration Convention that it has initiated the mutual agreement procedure. The competent authority initiating the mutual agreement procedure will also inform — on the basis of information available to it — the competent authority(ies) of the other Member State(s) and the person making the request whether the case was presented within the time limits provided for in Article 6(1) of the Arbitration Convention and of the starting point for the two-year period of Article 7(1) of the Arbitration Convention.

6.4. Exchange of position papers

(a) Member States undertake that when a mutual agreement procedure has been initiated, the competent authority of the country in which a tax assessment, i.e., a final decision of the tax administration on the income, or equivalent has been made, or is intended to be made, which contains an adjustment that results, or is likely to result, in double taxation within the meaning of Article 1 of the Arbitration Convention, will send a position paper to the competent authority(ies) of the other Member State(s) involved in the case setting out:

(i) the case made by the person making the request;

(ii) its view of the merits of the case, e.g. why it believes that double taxation has occurred or is likely to occur;

(iii) how the case might be resolved with a view to the elimination of double taxation together with a full explanation of the proposal.

(b) The position paper will contain a full justification of the assessment or adjustment and will be accompanied by basic documentation supporting the competent authority's position and a list of all other documents used for the adjustment.

(c) The position paper will be sent to the competent authority(ies) of the other Member State(s) involved in the case as quickly as possible taking account of the complexity of the particular case and no later than four months from the latest of the following dates:
   (i) the date of the tax assessment notice, i.e., final decision of the tax administration on the additional income, or equivalent;
   (ii) the date on which the competent authority receives the request and the minimum information as stated under point 5(a).
(d) Member States undertake that, where a competent authority of a country in which no tax assessment or equivalent has been made, or is not intended to be made, which results, or is likely to result, in double taxation within the meaning of Article 1 of the Arbitration Convention, e.g. due to a transfer pricing adjustment, receives a position paper from another competent authority, it will respond as quickly as possible taking account of the complexity of the particular case and no later than six months after receipt of the position paper.
(e) The response should take one of the following two forms:
   (i) if the competent authority believes that double taxation has occurred, or is likely to occur, and agrees with the remedy proposed in the position paper, it will inform the other competent authority(ies) accordingly and make such adjustments or allow such relief as quickly as possible;
   (ii) if the competent authority does not believe that double taxation has occurred, or is likely to occur, or does not agree with the remedy proposed in the position paper, it will send a responding position paper to the other competent authority(ies) setting out its reasons and proposing an indicative time scale for dealing with the case taking into account its complexity. The proposal will include, whenever appropriate, a date for a face-to-face meeting, which should take place no later than 18 months from the latest of the following dates:
      (aa) the date of the tax assessment notice, i.e., final decision of the tax administration on the additional income, or equivalent;
      (bb) the date on which the competent authority receives the request and the minimum information as stated under point 5(a).
(f) Member States will further undertake any appropriate steps to speed up all procedures wherever possible. In this respect, Member States should envisage to organise regularly, and at least once a year, face-to-face-meetings between their competent authorities to discuss pending mutual

agreement procedures (provided that the number of cases justifies such regular meetings).

6.5. Double taxation treaties between Member States

As far as transfer pricing cases are concerned, Member States are recommended to apply the provisions of points 1, 2 and 3 also to mutual agreement procedures initiated in accordance with Article 25(1) of the OECD Model Tax Convention on Income and on Capital, implemented in the double taxation treaties between Member States.

7. Proceedings during the second phase of the Arbitration Convention

7.1. List of independent persons

(a) Member States commit themselves to inform without any further delay the Secretary-General of the Council of the names of the five independent persons of standing, eligible to become a member of the advisory commission as referred to in Article 7(1) of the Arbitration Convention and inform, under the same conditions, of any alteration of the list.

(b) When transmitting the names of their independent persons of standing to the Secretary-General of the Council, Member States will join a curriculum vitae of those persons, which should, among other things, describe their legal, tax and especially transfer pricing experience.

(c) Member States may also indicate on their list those independent persons of standing who fulfill the requirements to be elected as Chairman.

(d) The Secretary General of the Council will address every year a request to Member States to confirm the names of their independent persons of standing or give the names of their replacements.

(e) The aggregate list of all independent persons of standing will be published on the Council's website.

(f) Independent persons of standing do not have to be nationals of or resident in the nominating State, but do have to be nationals of a Member State and resident within the territory to which the Arbitration Convention applies.

(g) Competent authorities are recommended to draw up an agreed declaration of acceptance and a statement of independence for the particular case, to be signed by the selected independent persons of standing.

7.2. Establishment of the advisory commission

(a) Unless otherwise agreed between the Member States concerned, the Member State that issued the first tax assessment notice, i.e., final decision of the tax administration on the additional income, or

equivalent which results, or is likely to result, in double taxation within the meaning of Article 1 of the Arbitration Convention, takes the initiative for the establishment of the advisory commission and arranges for its meetings, in agreement with the other Member State(s).

(b) Competent authorities should establish the advisory commission no later than six months following expiry of the period referred to in Article 7 of the Arbitration Convention. Where one competent authority does not do this, another competent authority involved is entitled to take the initiative.

(c) The advisory commission will normally consist of two independent persons of standing in addition to its Chairman and the representatives of the competent authorities. For triangular cases, where an advisory commission is to be set up under the multilateral approach, Member States will have regard to the requirements of Article 11(2) of the Arbitration Convention, introducing as necessary additional rules of procedure, to ensure that the advisory commission, including its Chairman, is able to adopt its opinion by a simple majority of its members.

(d) The advisory commission will be assisted by a secretariat for which the facilities will be provided by the Member State that initiated the establishment of the advisory commission unless otherwise agreed by the Member States concerned. For reasons of independence, this secretariat will function under the supervision of the Chairman of the advisory commission. Members of the secretariat will be bound by the secrecy provisions as stated in Article 9(6) of the Arbitration Convention.

(e) The place where the advisory commission meets and the place where its opinion is to be delivered may be determined in advance by the competent authorities of the Member States concerned.

(f) Member States will provide the advisory commission before its first meeting, with all relevant documentation and information and in particular all documents, reports, correspondence and conclusions used during the mutual agreement procedure.

7.3. Functioning of the advisory commission

(a) A case is considered to be referred to the advisory commission on the date when the Chairman confirms that its members have received all relevant documentation and information as specified in point 7.2(f).

(b) The proceedings of the advisory commission will be conducted in the official language or languages of the Member States involved, unless

the competent authorities decide otherwise by mutual agreement, taking into account the wishes of the advisory commission.

(c) The advisory commission may request from the party from which a statement or document emanates to arrange for a translation into the language or languages in which the proceedings are conducted.

(d) Whilst respecting Article 10 of the Arbitration Convention, the advisory commission may request Member States and in particular the Member State that issued the first tax assessment notice, i.e., final decision of the tax administration on the additional income, or equivalent, which resulted, or may result, in double taxation within the meaning of Article 1 of the Arbitration Convention, to appear before the advisory commission.

(e) The costs of the advisory commission procedure, which will be shared equally by the Member States concerned, will be the administrative costs of the advisory commission and the fees and expenses of the independent persons of standing.

(f) Unless the competent authorities of the Member States concerned agree otherwise:

  (i) the reimbursement of the expenses of the independent persons of standing will be limited to the reimbursement usual for high ranking civil servants of the Member State which has taken the initiative to establish the advisory commission;

  (ii) the fees of the independent persons of standing will be fixed at EUR 1000 per person per meeting day of the advisory commission, and the Chairman will receive a fee higher by 10 % than that of the other independent persons of standing.

(g) Actual payment of the costs of the advisory commission procedure will be made by the Member State which has taken the initiative to establish the advisory commission, unless the competent authorities of the Member States concerned decide otherwise.

7.4. Opinion of the advisory commission

Member States would expect the opinion to contain:

(a) the names of the members of the advisory commission;

(b) the request; the request contains:

  (i) the names and addresses of the enterprises involved;

  (ii) the competent authorities involved;

  (iii) a description of the facts and circumstances of the dispute;

  (iv) a clear statement of what is claimed;

(c) a short summary of the proceedings;

(d) the arguments and methods on which the decision in the opinion is based;
(e) the opinion;
(f) the place where the opinion is delivered;
(g) the date on which the opinion is delivered;
(h) the signatures of the members of the advisory commission.
(i) The decision of the competent authorities and the opinion of the advisory commission will be communicated as follows:
    (i) Once the decision has been taken, the competent authority to which the case was presented will send a copy of the decision of the competent authorities and the opinion of the advisory commission to each of the enterprises involved.
    (ii) The competent authorities of the Member States can agree that the decision and the opinion may be published in full. They can also agree to publish the decision and the opinion without mentioning the names of the enterprises involved and with deletion of any further details that might disclose the identity of the enterprises involved. In both cases, the enterprises' consent is required and prior to any publication the enterprises involved must have communicated in writing to the competent authority to which the case was presented that they do not have objections to publication of the decision and the opinion.
    (iii) The opinion of the advisory commission will be drafted in three (or more in the case of triangular cases) original copies, one to be sent to each competent authority of the Member States involved and one to be transmitted to the Secretariat-General of the Council for archiving. If there is agreement on the publication of the opinion, the latter will be rendered public in the original language(s) on the website of the Commission.

8. Tax collection and interest charges during cross-border dispute resolution procedures

(a) Member States are recommended to take all necessary measures to ensure that the suspension of tax collection during cross-border dispute resolution procedures under the Arbitration Convention can be obtained by enterprises engaged in such procedures under the same conditions as those engaged in a domestic appeals or litigation procedure although these measures may imply legislative changes in some Member States. It would be appropriate for Member States to extend these measures to

the cross-border dispute resolution procedures under double taxation treaties between Member States.

(b) Considering that, during mutual agreement procedure negotiations, a taxpayer should not be adversely affected by the existence of different approaches to interest charges and refunds during the time it takes to complete the mutual agreement procedure, Member States are recommended to apply one of the following approaches:
   (i) tax to be released for collection and repaid without attracting any interest; or
   (ii) tax to be released for collection and repaid with interest; or
   (iii) each case to be dealt with on its merits in terms of charging or repaying interest (possibly during the mutual agreement procedure).

9. Accession of new Member States to the Arbitration Convention

Member States will endeavour to sign and ratify the conventions on accession of new Member States to the Arbitration Convention as soon as possible and in any event no later than two years after their accession to the EU.

10. Final provisions

In order to ensure the even and effective application of this Code of Conduct, Member States are invited to report to the Commission on its practical functioning every two years. On the basis of these reports, the Commission intends to report to the Council and may propose a review of the provisions of this Code of Conduct.

[1] Reservations: Bulgaria holds the view that profit adjustments arising from an adjustment to the price of a loan (i.e., the interest rate) fall within the scope of the Arbitration Convention. On the contrary, Bulgaria considers that the Arbitration Convention does not cover cases of profit adjustments based on adjustments to the amount of financing. In principle the grounds for such adjustments lay in the domestic legislation of Member States. The operation of varying national rules and the absence of an internationally recognized arms' length set of guidelines to be applied to a business' capital structure, to a great extent challenge the arms' length character of profit adjustments based on adjustments to the amount of a loan. The Czech Republic shall not apply the mutual agreement procedure under the Arbitration Convention in case that is a subject to the anti-abuse rules under the domestic law. The Netherlands endorses the view that an adjustment of the interest rate (pricing of the loan) which is based on national legislation based on the arm's length principle falls within the scope of the Arbitration Convention. Adjustments of the amount of the loan as well as adjustments of the deductibility of the interest based on a

thin capitalization approach under the arm's length principle or adjustments based on anti-abuse legislation based on the arm's length principle are considered to fall outside the scope of the Arbitration Convention. The Netherlands will preserve its reservation until there is guidance from the OECD on how to apply the arm's length principle to thin capitalization of associated enterprises. Greece considers that adjustments which fall within the scope of Arbitration Convention are those of the interest rate of a loan. Adjustments concerning the amount of a loan and the deductibility of accrued interest related to a loan should not apply to Arbitration Convention, due to domestic legislation limitations in force. Hungary considers only those cases fall within the scope of the AC where double taxation is due to the adjustment of the interest rate of the loan and the adjustment is based on the ALP. Italy considers that the Arbitration Convention may be invoked in case of double taxation due to a price adjustment of a financial transaction not in accordance with the arm's length principle. Conversely, it cannot be invoked to solve double taxation arising from adjustments to the amount of loans, or double taxation occurred because of the differences in domestic rules on the allowed amount of financing or on interest deductibility. Latvia's understanding is that the Arbitration Convention cannot be invoked in case of double taxation arising as a result of application of general national legislation on adjustments of the amount of a loan or on deductibility of interest payments, that is not based on the arm's length principle provided for in Article 4 of the Arbitration Convention. Therefore, Latvia considers that only adjustments of interest deductions performed under national legislation based on the arm's length principle are within the scope of the Arbitration Convention. Poland considers that procedure stipulated by Arbitration Convention may be applicable only in the case of interest adjustments. While adjustments concerning amount of a loan should not be covered by the Convention. In our opinion it is quite impossible to define how capital structure should look in practice in order to be in line with arm's length principle. Portugal considers that the Arbitration Convention cannot be invoked to resolve cases of double taxation caused by adjustments to profits arising either from corrections to the amount of a loan contracted between associated companies or to interest payments based on domestic anti-abuse measures. Nevertheless, Portugal admits to review its position once consensus is reached at international level, namely through guidance from the OECD, on the application of the arm's length principle to the amount of debts (involving thin capitalisation situations) between associated companies. Slovakia is of the opinion that an adjustment of the interest rate which is based on national legislation based on the arm's length principle should fall within the scope of

the Arbitration Convention but the adjustments to profits arising as a result of the application of anti-abuse rules under domestic legislation should fall outside the scope of the Arbitration Convention.

[2] Reservation: The tax authority Member from Italy considers "the date of the first tax assessment notice or equivalent reflecting a transfer pricing adjustment which results or is likely to result in double taxation within the meaning of Article 1" as the starting point of the three-year period, since the application of the existing Arbitration Convention should be limited to those cases where there is a transfer pricing "adjustment".

APPENDIX V: COMPARISON OF ICC AND ICSID: TERMS OF REFERENCE

ICC Rules, Article 23, Terms of Reference

1. As soon as it has received the file from the Secretariat, the arbitral tribunal shall draw up, on the basis of documents or in the presence of the parties and in the light of their most recent submissions, a document defining its Terms of Reference. This document shall include the following particulars:
   a) the names in full, description, address and other contact details of each of the parties and of any person(s) representing a party in the arbitration;
   b) the addresses to which notifications and communications arising in the course of the arbitration may be made;
   c) a summary of the parties' respective claims and of the relief sought by each party, together with the amounts of any quantified claims and, to the extent possible, an estimate of the monetary value of any other claims;
   d) unless the arbitral tribunal considers it inappropriate, a list of issues to be determined;
   e) the names in full, address and other contact details of each of the arbitrators;
   f) the place of the arbitration; and
   g) particulars of the applicable procedural rules and, if such is the case, reference to the power conferred upon the arbitral tribunal to act as *amiable compositeur* or to decide *ex aequo et bono*.[581]
2. The Terms of Reference shall be signed by the parties and the arbitral tribunal. Within two months of the date on which the file has been transmitted to it, the arbitral tribunal shall transmit to the Court the Terms of Reference signed by it and by the parties. The Court may extend this time

[581] *Ex aequo et bono* (Latin for "according to the right and good" or "from equity and conscience") is a phrase derived from Latin that is used as a legal term of art. In the context of arbitration, it refers to the power of the arbitrators to dispense with consideration of the law and consider solely what they consider to be fair and equitable in the case at hand. *amiable compositeur* is a French indicating conciliator.

limit pursuant to a reasoned request from the arbitral tribunal or on its own initiative if it decides it is necessary to do so.

3. If any of the parties refuses to take part in the drawing up of the Terms of Reference or to sign the same, they shall be submitted to the Court for approval. When the Terms of Reference have been signed in accordance with Article 23(2) or approved by the Court, the arbitration shall proceed.
4. After the Terms of Reference have been signed or approved by the Court, no party shall make new claims which fall outside the limits of the Terms of Reference unless it has been authorized to do so by the arbitral tribunal, which shall consider the nature of such new claims, the stage of the arbitration and other relevant circumstances.

ICSID Rules, Rule 19 and 20

Rule 19
Procedural Orders
The Tribunal shall make the orders required for the conduct of the proceeding.

Rule 20
Preliminary Procedural Consultation
(1) As early as possible after the constitution of a Tribunal, its President shall endeavor to ascertain the views of the parties regarding questions of procedure. For this purpose he may request the parties to meet him. He shall, in particular, seek their views on the following matters:

(a) the number of members of the Tribunal required to constitute a quorum at its sittings;
(b) the language or languages to be used in the proceeding;
(c) the number and sequence of the pleadings and the time limits within which they are to be filed;
(d) the number of copies desired by each party of instruments filed by the other;
(e) dispensing with the written or the oral procedure;
(f) the manner in which the cost of the proceeding is to be apportioned; and
(g) the manner in which the record of the hearings shall be kept.

(2) In the conduct of the proceeding the Tribunal shall apply any agreement between the parties on procedural matters, except as otherwise provided in the Convention or the Administrative and Financial Regulations.

APPENDIX VI: VIENNA CONVENTION, SECTION 3

Vienna Convention on the Law of Treaties, Section 3: Interpretation of Treaties.

Article 31

General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
   (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
   (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. There shall be taken into account, together with the context:
   (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
   (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
   (c) any relevant rules of international law applicable in the relations between the parties.
4. A special meaning shall be given to a term if it is established that the parties so intended.

Article 32

Supplementary means of interpretation

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(a) leaves the meaning ambiguous or obscure; or
(b) leads to a result which is manifestly absurd or unreasonable.

Article 33

Interpretation of treaties authenticated in two or more languages

1. When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall prevail.
2. A version of the treaty in a language other than one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree.
3. The terms of the treaty are presumed to have the same meaning in each authentic text.
4. Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference of meaning which the application of articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.