

RESOLVING DOUBLE TAX TREATY
DISPUTES: THE CHALLENGES OF
MUTUAL AGREEMENT PROCEDURE
WITH A SPECIAL FOCUS
ON ADDRESSING THE CONCERNS
OF DEVELOPING COUNTRIES IN
AFRICA — THE SOUTH AFRICAN
AND UGANDAN EXPERIENCE

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Introduction

Under contract law parties may agree, upon a breach of any of the provisions in the agreement, the aggrieved party may institute legal action to seek appropriate relief. A double tax treaty (DTA) is essentially an agreement between two contracting states that regulates the taxation of income derived from cross-border transactions of the residents of the two states, alleviates any impediments to cross-border transactions (for instance the double-taxation of income) as well as prevents any fiscal evasion and avoidance of income by such residents. When a country enters into a DTA with another country, generally, the treaty becomes part of the domestic tax law of that country. In South Africa, for instance, section 231(2) of the Constitution of the Republic of South Africa, 1996, read together with section 108(1) of the Income Tax Act,² provides that as soon as the double tax treaty is ratified and is published in the *Government Gazette*, its provisions are effective as if they had been incorporated into the Income Tax Act.³ This measure

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¹ L Olivier & M Honiball *International Tax: A South African Perspective* 5 ed (2011) 276.

² Act 58 of 1962.

³ Olivier & Honiball (note 1 above) 479; D Meyerowitz *Meyerowitz on Income Tax* (2009) para 30.11; K Huxham & P Haupt *Notes on South African Income Tax* (2016) 356; AW Oguttu 'Curbing "treaty shopping": The "beneficial ownership" provision analysed from a South African perspective' (2007) 40 *Comparative and*

implies that any dispute that arises in a treaty context may be resolved through the country's court system. In Uganda, section 88(1) and 88(2) of the Income Tax Act, Cap 340 provides that an international agreement entered into between the Government of Uganda and the government of a foreign country shall have effect as if the agreement was contained in the Income Tax Act. Therefore, disputes that arise in respect of taxability of income covered by any tax treaty Uganda has signed may be objected to and appealed to the Tax Appeals Tribunal, High Court and Court of Appeal in Uganda. In most countries, however, due to the complexities and large amounts of monies involved, tax cases are often settled out of court.⁴ Apart from the judicial remedies in a country's court systems there are administrative remedies that apply in constitutional countries, which entail constitutional imperatives that require tax administrations to respect taxpayer's rights, as well as provisions that require tax administrations to ensure tax disputes are resolved in a just and lawful manner.

However, taxpayers involved in cross-border transactions often find that the resolution of treaty disputes using domestic legal remedies may not be satisfactory due to the international nature of the transactions involved. However, there is no international court that deals with disputes that arise from tax treaties. Instead, tax treaties generally provide for the Mutual Agreement Procedure (MAP) in article 25 of treaties based on the OECD and the UN Model Tax Conventions (MTCs – which are the main MTCs used to sign treaties internationally) as the means for resolving tax treaty disputes. The MAP is administered by the 'competent authorities' of the contracting states who are generally named under article 3(f) of the treaties based on the OECD MTC. In South Africa, for instance, the competent authority is the Commissioner for the South African Revenue Service.⁵ Article 25 requires the competent authorities to resolve issues relating to the interpretation and application of the treaty.⁶

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⁴ For example, in South Africa, SARS allows tax disputes to be subjected to the Alternative Dispute Resolution process whereby resolution of the same can be by agreement or settlement out of court between the taxpayer and SARS. See SARS 'Alternative Dispute Resolution: What to do if you dispute your tax assessment' (31 October 2014) para 9, available at <http://www.sars.gov.za/AllDocs/Ops-Docs/Guides/LAPD-Tadm-G07%20-%20Guide%20on%20Dispute%20of%20a%20Tax%20Assessment%20-%20External%20Guide.pdf> (accessed 24 August 2016).

⁵ SARS 'Mutual Agreement Procedure (MAP)', available at <http://www.sars.gov.za/Legal/International-Treaties-Agreements/DTA-Protocols/Pages/Mutual-Agreement-Procedure.aspx> (accessed 23 August 2016).

⁶ See para 1 of the *Commentary on article 25 of the OECD MTC* and para 2 of the *Commentary on article 25 of the UN MTC*. See also A Zaimaj 'Dispute avoidance

However, the problem is that the taxpayers and the tax authorities of most developing countries are often uncertain about the MAP, which partly explains why there are few MAP cases in developing countries, notwithstanding the fact that tax treaty disputes often arise. In Africa, MAP is largely undeveloped and many tax authorities lack experience of the procedure. The purpose of this article is to clearly explain the MAP and to clarify the responsibilities of the parties involved. The article further explains the similarities and differences between the MAP under the OECD and the UN MTC. The article discusses the factors that have hindered the effectiveness of MAP internationally, the steps that the international community has taken to resolve those hindrances and the reasons why developing countries, such as those in Africa, are still sceptical about MAP. Examples of MAP matters that have arisen in South Africa and Uganda are provided to illustrate the importance of developing MAP experience in Africa. The article explains the OECD's recommendations for ensuring effective MAP as set out in Action 14 of its 2015 Report on addressing 'base erosion and profit shifting',⁷ as well as the guidance offered by the UN in its 2012 Guide to MAP for developing countries that have signed treaties based on the UN MTC.⁸ In light of the above, recommendations are provided as to how the MAP challenges developing countries face can be effectively addressed.

The Mutual Agreement Procedure

Applying for MAP

Article 25(1)⁹ of both the OECD and the UN MTCs highlights the following regarding applying for MAP.

and resolution' in K Spies & R Petrucci (eds) *Tax Policy Challenges in the 21st Century* (2014) 273.

⁷ OECD *Making dispute resolution mechanisms more effective: Action 14* (2015) para 4.

⁸ United Nations *Guide to Mutual Agreement Procedure in tax treaties* (2012), available at http://www.un.org/esa/ffd/tax/gmap/Guide_MAP.pdf (accessed 16 May 2014).

⁹ Art 25(1) states: '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'.

The taxpayer's right to MAP: Taxpayers, who believe that they have not been taxed in accordance with the treaty rules that allocate taxing rights between the two contracting states, have a right to request that they are taxed according to those rules.¹⁰

Relationship between MAP and domestic law: Article 25(1) makes it clear that MAP in principle is available to the taxpayers irrespective of any judicial and administrative remedies available under the domestic law of the contracting states. Indeed, the Constitutions and/or domestic law of many countries normally provide that no person can be deprived of the judicial remedies available under domestic law. Paragraph 34 of the Commentary on article 25 of the OECD MTC clarifies that a taxpayer's choice of recourse between domestic remedies and MAP is only constrained by applicable time limits in domestic law statutes of limitation or by the time limits in article 25(1) – discussed below. It is therefore important for taxpayers to understand the relationship between domestic remedies and MAP in their countries. In some countries the procedural rules of tax administrations do not permit a MAP case and domestic remedies to run at the same time: one process must take precedence over the other.¹¹ In some countries, if a domestic court has decided on a case, the competent authority is bound by the decision and may not be in a position to engage in MAP with the other state.¹² In other countries, even though the right to apply for domestic remedies and for MAP is open to the taxpayer, there may be rules that require taxpayers to waive all their rights under domestic law before the competent authority can accept a MAP case. States that take this position are usually concerned about devoting their resources and efforts to find a MAP solution which the taxpayer may ultimately reject (as explained below).¹³ In other states taxpayers are required to suspend domestic law remedies when they apply for MAP. In such cases, it is important that the taxpayer obtains a waiver of time limits as required under domestic law to ensure that the domestic remedies are available if MAP results are not satisfactory.¹⁴

Eligibility to apply for MAP: In terms of paragraphs 31 and 34 of the OECD Commentary on article 25, to apply for MAP the taxpayer must be

¹⁰ Para 7 of the *Commentary on article 25(1) of the OECD MTC*; United Nations *United Nations Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries* (2013) 311.

¹¹ OECD *Making Dispute Resolution Mechanisms More Effective – Action 14, 2015 Final Report* (OECD/G20 Base Erosion and Profit Shifting Project) para 51; para 76 of the *Commentary on article 25(5) of the OECD MTC*.

¹² Para 35 of the *Commentary on article 25 of the OECD MTC*; UN *Handbook on Selected Issues* (note 10 above) 312.

¹³ UN *Handbook on Selected Issues* (note 10 above) 312.

¹⁴ Para 44 the *Commentary on article 25 of the OECD MTC*.

a resident of one of the contracting states;¹⁵ the only exception is where the dispute relates to non-discrimination under article 24(1). In that case the taxpayer can be a national of one of the contracting states.

Cause of action: The taxpayer has to establish that an action by one or both of the states results, or will result, in taxation not in accordance with the treaty. Thus, the taxpayer can apply for MAP not only where the tax is charged but also if the actions of the states 'will result' in inappropriate taxation, for example, if an enacted law would result in inappropriate taxation for the taxpayer.¹⁶ MAP can also be applied for if a taxpayer becomes aware that the tax authority is going to impose tax not in accordance with the treaty, for example, the denial of a claim for refund or the issuance of a notice of liability.¹⁷

Scope of MAP disputes: MAP applies to disputes that may arise under any article of the treaty. The bulk of MAP cases involve transfer pricing disagreements (under article 9) concerning the transfer price between related entities.¹⁸ There can be 'economic double taxation' disputes where the same income is taxed in the hands of two different taxpayers,¹⁹ for example, when a transfer pricing adjustment under article 9(2) is made to increase the income of one of the related parties and yet the same income is taxed by the other state in the hands of its resident taxpayer.²⁰ Paragraph 11 of the Commentary on article 25 of the OECD MTC provides that economic double taxation resulting from transfer pricing adjustments is not within the 'spirit' of the treaty and that it should fall within the scope of MAP. MAP disputes often arise

¹⁵ Art 4(1) of the OECD MTC defines the term 'resident of a Contracting State' as 'any person who, under the laws of that state, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that state in respect only of income from sources in that state or capital situated therein'. See also Zaimaj 'Dispute avoidance and resolution' (note 6 above) 277.

¹⁶ Para 19 of the *Commentary on article 25(1) of the OECD MTC*; UN *Handbook on Selected Issues* (note 10 above) 314.

¹⁷ UN *Handbook on Selected Issues* (note 10 above) 318.

¹⁸ Transfer pricing refers to the artificial setting of prices at which related entities transfer goods or services between each other to avoiding taxes in a specific country. See AW Oguttu 'Transfer pricing and tax avoidance: Is the arm's length principle still relevant in the e-commerce era?' (2006) 18 *SA Mercantile Law Journal* 138 139

¹⁹ For details on economic double taxation see R Rohatgi *Basic International Taxation* (2002) 12. See also Zaimaj 'Dispute avoidance and resolution' (note 6 above) 277.

²⁰ Paras 10 and 11 of the *Commentary on article 25(1) and (2) of the OECD MTC*; UN *Handbook on Selected Issues* (note 10 above) 323.

with respect to the question of whether a permanent establishment (PE) exists, to the attributing of profits to PEs and in allocating profits between a PE and the head office.²¹ Disputes can be about 'juridical double taxation'; where the same income is taxed by both states in the hands of the same taxpayer.²² There can be disputes regarding the appropriate residence of a person, whether it is the residence or the source state that has the right to tax income or whether the residence state is required to give double tax relief with respect to treaty distributive rules.²³

Jurisdiction to apply for MAP: The request for MAP has to be made in the state in which the taxpayer is a resident even if the claim relates to taxation imposed by the other state.²⁴

The time to request MAP: The taxpayer must present the MAP case within three years from the first notification that taxation is not in accordance with the provisions of the treaty. The minimum time limit is intended to protect administrations against late objections, but the contracting states can agree on longer periods in the interest of the taxpayer.²⁵

Must tax be paid before applying for MAP? The domestic legislation of some states requires that tax be paid before applying for MAP. For example, in South Africa the 'pay now argue later'²⁶ principle applies, in that payment of an assessed tax is not suspended by an objection, appeal or a pending decision of a court of law. However, article 25 does not require the taxpayer to have paid tax before requesting MAP. The OECD and the UN MTC recommend that the obligation to pay tax be suspended or deferred during the MAP process.²⁷ This suspension

²¹ Para 55 of the *Commentary on article 25 of the OECD MTC*; Zaimaj 'Dispute avoidance and resolution' (note 6 above) 277. The meaning of the PE concept is set out in art 5 of the OECD MTC and attributing of profits to PEs is dealt with under art 7 of the OECD MTC. See AW Oguttu & S Tladi 'E-commerce: A critique on the determination of a "permanent establishment" for income tax purposes from a South African perspective' (2009) 20 *Stellenbosch Law Review* 74; AW Oguttu 'The challenges of taxing profits attributed to permanent establishments: A South African perspective' (2010) 64 *Bulletin for International Taxation* 165.

²² For details on 'juridical double taxation' see AW Oguttu 'Resolving double taxation: The concept "place of effective management" analysed from a South African perspective' (2008) 41 *Comparative and International Law Journal of Southern Africa* 80.

²³ Paras 13, 14 of the *Commentary on article 25(1) and (2) of the OECD MTC*.

²⁴ Para 17 of the *Commentary on article 25(1) and (2) of the OECD MTC*.

²⁵ Para 20 of the *Commentary on article 25 of the both the OECD and UN MTC*.

²⁶ See s 164(1)(a) of South Africa's Tax Administration Act 28 of 2011. The 'pay now argue later' rule was established in *Metcash Trading Ltd v Commissioner for the South African Revenue Service & another* 2001 (1) SA 1109 (CC).

²⁷ Para 46 of the *Commentary on article 25 of the OECD MTC*; UN *Handbook on Selected Issues* (note 10 above) 316.

prevents the taxpayer from having cash-flow problems and the payment of refunds (plus any accruing interest) if the competent authority finds the taxpayer's MAP request to be justified.²⁸

Taxpayer's involvement after applying for MAP: Once the taxpayer has submitted a request for a MAP the process has to be left in the hands of the governments involved with no undue interference by the taxpayer.²⁹ Nevertheless, necessary co-operation is still required between the taxpayer and the competent authorities. The taxpayer, for instance, is required to provide the necessary information regarding the case to the competent authority in its state of residence which, in turn, communicates that information to the other state.³⁰

The duties of the competent authorities

Article 25(2)³¹ of both the OECD and the UN MTCs highlights the following regarding the duties of the competent authorities of the contracting states.

Unilateral MAP: The competent authority of the taxpayer's country of residence must first determine 'if the objection appears to be justified'.³² Since this determination gives wide discretion to the competent authority, some countries tend to deny access to the MAP where the transaction in question is covered by a domestic anti-avoidance provision.³³ Access to MAP has also been denied where there are violations of domestic law which involve significant penalties.³⁴ However, article 25 requires that if the taxpayer's objection appears to be justified, the competent authority should first endeavour to resolve the case unilaterally, for example, by granting a tax credit or giving an exemption in case of double taxation.

Bilateral MAP: If a unilateral resolution is not successful, the competent authority of the taxpayer's country of residence shall contact

²⁸ Paras 47 and 48 of the *Commentary on article 25 of the OECD*; *UN Handbook on Selected Issues* (note 10 above) 316.

²⁹ *UN Handbook on Selected Issues* (note 10 above) 319.

³⁰ *Ibid.*

³¹ Art 25(2) states: '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'.

³² Zaimaj 'Dispute avoidance and resolution' (note 6 above) 277.

³³ Para 26 of the *Commentary on article 25 of the OECD MTC* and para 9 of the *Commentary on article 25 of the OECD MTC*.

³⁴ *UN Handbook on Selected Issues* (note 10 above) 318.

the competent authority of the other contracting state to begin bilateral discussions so as to resolve the case by mutual agreement.³⁵

Implementation of the agreement reached: Even though the implementation of the agreement depends on the procedural rules in the two states, article 25(2) specifies that ‘an agreement shall be implemented notwithstanding any time limits of domestic law’ which could hinder the effectiveness of the MAP, for instance, by preventing a tax assessment from being amended in favour of the taxpayer.³⁶

The role of the competent authorities in resolving the dispute

Article 25(3)³⁷ requires that the competent authorities ‘endeavour to resolve’ the dispute by mutual agreement. Article 25(3) does not require the competent authorities to resolve the matter.

Communication between the competent authorities

Article 25(4)³⁸ permits the competent authorities to consult each other to resolve any difficulties or doubts arising from the interpretation or application of the treaty.

Format of communications: The competent authorities may communicate with each other directly in writing or orally. Joint commissions consisting of themselves or their representatives can be utilised, which ensures efficient communication, thereby overcoming any cumbersome formal rules which usually govern intergovernmental communications.³⁹

Confidentiality of communications: All information exchanged under the MAP is subject to the confidentiality requirements in article 26(2), which requires that 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. Such information shall be disclosed only

³⁵ Para 50 of the *Commentary on article 25 of the OECD MTC*; *UN Handbook on Selected Issues* (note 10 above) 310.

³⁶ *UN Handbook on Selected Issues* (note 10 above) 167.

³⁷ Art 25(3) states: ‘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’. See also Zaimaj ‘Dispute avoidance and resolution’ (note 6 above) 277.

³⁸ Art 25(4) states: ‘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’.

³⁹ Paras 57, 58 and 62 of the *Commentary on article 25 of the OECD MTC*.

to persons or authorities (including courts and administrative bodies) concerned with the assessment, collection or enforcement of the tax or those concerned with the prosecution or determination of appeals in relation to the tax case.

Expected outcome: The communication between the competent authorities is expected to result in an agreement as to how the treaty should be applied to the taxpayer's case. The taxpayer has the right to accept the results of the MAP and give up the domestic remedies or to reject the MAP and seek judicial relief under the domestic legal system.⁴⁰

Consequences if no agreement is reached: A factor that historically has been a major hindrance to the effectiveness of MAP has been the lack of a requirement in article 25 for the competent authorities to reach agreement and conclude the matter.⁴¹ This lack led to long procedures and a backlog of unresolved issues. In 2004 the OECD issued a report on 'Improving the process for resolving international tax disputes',⁴² which proposed the development of a binding arbitration process to resolve disagreements arising in the course of a MAP case. This report culminated in the addition of an arbitration provision (explained below) to the OECD MTC, in 2008, as an integral part of the MAP process.

Arbitration under MAP

Article 25(5)⁴³ provides for arbitration as an extension of the MAP.

The function of the arbitration provision: Arbitration is not intended to

⁴⁰ UN *Handbook on Selected Issues* (note 10 above) 312; Zaimaj 'Dispute avoidance and resolution' (note 6 above) 277.

⁴¹ UN *Handbook on Selected Issues* (note 10 above) 167.

⁴² OECD *Improving the process for resolving international tax disputes* (2004), available at <http://www.oecd.org/tax/treaties/33629447.pdf> (accessed 12 September 2015).

⁴³ Art 25(5) 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,
- c) any unresolved issues arising from the case shall be submitted to arbitration if the person so requests. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the

decide the case itself but to provide resolution for only the specific issues that prevent the competent authorities from reaching a satisfactory resolution of the case. This distinguishes arbitration under MAP from commercial or government-private party arbitration where the jurisdiction of the arbitral panel extends to resolving the whole case.⁴⁴

Time to apply for arbitration: Article 25(5)(b) of the OECD MTC provides that within two years from the time the taxpayer presents the case to the competent authority of his country of residence up to the time when the competent authorities of the two states are unable to reach an agreement to resolve the case, the taxpayer may request that any unresolved issues be submitted for arbitration. Thus, a two-year period must run before arbitration can be requested. The taxpayer may decide to wait beyond the end of the two-year period to allow the competent authorities more time to resolve the case under article 25(2).⁴⁵

Condition to apply for arbitration: The unresolved issues submitted for arbitration should not have been decided upon by a court or administrative tribunal of either state.⁴⁶

Advantages of arbitration: Taxpayers have a particular interest in arbitration because it provides certainty that their cases can be resolved expeditiously under MAP. Expeditious resolution of cases in turn encourages cross-border investment.⁴⁷ Taxpayers also prefer arbitration to resolving disputes through domestic remedies as these pose risks of inconsistent court decisions in both countries and concerns about unilateral interpretation of the treaty based on domestic law.⁴⁸

(i) *The procedure for arbitration*

The arbitration process is not dependent on prior authorisation by the competent authorities. Once the procedural requirements have been met a taxpayer can request that the unresolved issues be submitted for arbitration.⁴⁹ Both the OECD and the UN MTCs have 'Sample Mutual Agreements on Arbitration' which set out the technical and procedural aspects of the arbitration procedure. Under the OECD Sample Mutual Agreement on Arbitration an aggrieved taxpayer must make a request

Contracting States shall by mutual agreement settle the mode of application of this paragraph.'

⁴⁴ Para 64 of the *Commentary on article 25 of the OECD MTC*; *UN Handbook on Selected Issues* (note 10 above) 334.

⁴⁵ Para 70 of the *Commentary on article 25(5) of the OECD MTC*.

⁴⁶ Para 76 of the *Commentary on article 25(5) of the OECD MTC*.

⁴⁷ UN Committee of Experts on International Cooperation in Tax Matters *Secretariat paper on alternative dispute resolution in taxation* (8 October 2015) 3.

⁴⁸ *Ibid.*

⁴⁹ Para 63 of the *Commentary on article 25(5) of the OECD MTC*.

for arbitration in writing stating the unresolved issues arising from the case and send this to one of the competent authorities, accompanied by a written statement that no decision on the case has been rendered by a court or administrative tribunal of the states.⁵⁰ Within ten days of receipt of the request the competent authority who receives the request shall send a copy to the other competent authority.⁵¹ Within three months after the taxpayer's request for arbitration the competent authorities are expected to agree on the questions to be resolved by the arbitration panel and to communicate them in writing to taxpayer. This constitutes the 'terms of reference' for the issues to be decided upon.⁵² Thereafter, each competent authority must appoint an arbitrator. Within two months of appointment the arbitrators are expected to appoint a third arbitrator who functions as the Chair and makes the final decision.⁵³ If no appointment is made within that time the Director of the OECD Centre for Tax Policy and Administration has to appoint the Chair within ten days of receiving a request to do so from the taxpayer.⁵⁴ 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.⁵⁵ The OECD sample mutual agreement on arbitration does not set out any special qualifications for the arbitrators.⁵⁶

Who bears the costs of arbitration? Paragraph 13 of the OECD sample mutual agreement provides, unless agreed otherwise, each competent authority is supposed to bear the costs of appointing its arbitrator. The costs of the third arbitrator and other general costs can be shared equally. The UN sample agreement recognises that when there is a significant disparity in the level of development between the two states it may be possible to agree on other methods of allocating costs.⁵⁷ Paragraph 12 of the Commentary on article 25 of both the OECD and UN MTCs provides, unless agreed otherwise, the competent authority to which the arbitration case was initially presented will be responsible for the logistical arrangements of the arbitral panel meetings and will provide the administrative personnel necessary for the conduct of the arbitration process. Thus, in most cases, the dispute would be heard in that country where the arbitration case was first reported.

⁵⁰ OECD 'Sample mutual agreement on arbitration', which is annexed to the *Commentary on article 25* – see para 1 thereof.

⁵¹ *Ibid.*

⁵² OECD 'Sample mutual agreement on arbitration' (note 50 above) para 3.

⁵³ *Id* para 5.

⁵⁴ *Ibid.*

⁵⁵ *Id* para 7.

⁵⁶ *Id* para 3.

⁵⁷ UN *Handbook on Selected Issues* (note 10 above) 337.

(ii) *The arbitral decision*

The arbitration panel does not itself formally dispose of the issue, rather it is the competent authorities who are obliged to dispose of the issue in conformity with the arbitration panel's decision. Since the treaty is an agreement between the contracting states, the arbitration decision is binding on both contracting states and has to be implemented notwithstanding the time limits in the domestic laws of the contracting states.⁵⁸ The decision is final with no possibility for review or appeal by any board.⁵⁹ The arbitral decision, however, is not binding on the taxpayer, who can still approach the domestic courts to settle the matter.⁶⁰

Where the taxpayer agrees to the arbitral decision, there may be risks if the competent authority of the other state fails to implement the decision, since the enforceability of the award may be dependent on the domestic law and court system of the relevant country. In some states an arbitral award rendered in one country may not be formally enforceable in another country. Thus, the lack of effective enforcement could undermine the effectiveness of the arbitration mechanism.⁶¹

(iii) *Types of arbitration decisions*

There are two types of arbitration decisions: the reasoned and short form decisions.

Reasoned decisions: Under this approach, the decision is based on a full explanation of the arbitration panel's assessment of the case with the intention of a cohesive approach to treaty interpretation. In principle, the outcome is not made public; however, with the permission of the taxpayer and the competent authorities the decision can be made public in a redacted manner without mentioning the names of the parties or any details regarding their identity.⁶² Although the approach has no formal precedential values, it provides the possibility for the decision to be followed to settle future cases involving the same issue. In the OECD MTC, reasoned decisions are the default approach.⁶³

Short form decisions: Both the OECD and the UN MTCs allow the use of 'short form' arbitration. Under this approach each competent authority submits an offer to settle the dispute (its desired result) and

⁵⁸ Para 81 of the *Commentary on article 25(5) of the OECD MTC*; see also Olivier & Honiball (note 1 above) 475.

⁵⁹ Para 77 of the *Commentary on article 25(5) of the OECD MTC*.

⁶⁰ *Ibid.*

⁶¹ *UN Secretariat paper on alternative dispute resolution in taxation* (note 47 above) para 148.

⁶² OECD 'Sample mutual agreement on arbitration' (note 50 above) para 15.

⁶³ *Ibid.*

the arbitrators simply pick one of the two options without any fully written explanation justifying the result, but only 'short reasons' explaining the choice they make, and the outcome is not made public.⁶⁴ In the UN MTC, short form arbitration is the default approach.⁶⁵ However, the UN Sample Agreement provides that the terms of reference may allow the competent authorities to use the 'reasoned approach' in which case it could be possible, with the approval of both the competent authorities and the taxpayer, to publish a redacted version of the decision, which can be helpful in resolving other cases in the future.⁶⁶

The advantages of short form arbitration are that it keeps the costs low and speeds up the process,⁶⁷ as there is no need to have experts on the procedural and jurisdiction matters relating to arbitration, since the focus of the arbitrators is on more substantive tax issues.⁶⁸

The disadvantages of short form arbitration are that it may not lead to an outcome that is in accordance with the treaty as it only allows the arbitrators to choose between one of the solutions submitted. The winning country gets all the tax revenue while the other loses. Moreover, there is no reasoned opinion justifying the result.⁶⁹ The lack of jurisprudence on precedents to follow can furthermore lead to legal uncertainty.⁷⁰ In fact, of the two approaches, short form arbitration poses more transparency concerns.⁷¹ Decisions reached under short form arbitration may favour those with the most experience in presenting a compelling argument over those with better underlying arguments that may not be well presented. Short form arbitration is also considered more beneficial among countries that have many tax issues arising between them that require quick resolution. This is exemplified by arbitration between the USA and Canada, in which the USA Internal Revenue Service is reported to have won three of the binding arbitration decisions and Canada none.⁷² For countries that do not have frequent MAP cases there may be

⁶⁴ Para 6 of the UN sample agreement annex to the *Commentary on article 25(5) (Alternative B) of the UN MTC*.

⁶⁵ UN *Handbook on Selected Issues* (note 10 above) 331.

⁶⁶ Id 336.

⁶⁷ UN *Secretariat paper on alternative dispute resolution in taxation* (note 47 above) para 25.

⁶⁸ Id para 39.

⁶⁹ UN *Handbook on Selected Issues* (note 10 above) 331.

⁷⁰ UN *Secretariat paper on alternative dispute resolution in taxation* (note 47 above) para 40.

⁷¹ This type of procedure is sometimes known as baseball arbitration, due to the fact that the salaries of US major league baseball players have been negotiated in this manner.

⁷² P Temple-West 'International arbitration for tax disputes, "baseball" style' *Reuters* (25 November 2012), available at <http://www.reuters.com/article/2012/11/25/>

concerns that short form arbitration, especially in transfer pricing cases which often involve lots of tax revenue at stake, may result in great loss of revenue.⁷³

(iv) Difference in arbitration between the OECD and UN MTCs

Alternative approaches in the UN MTC: Under the UN Model, a cautious approach in adopting the arbitration provision was followed: two alternatives to article 25 are provided which are designed to address the different situations that developing countries face. Article 25 Alternative A does not include an arbitration provision. It is intended to cater for developing countries that are reluctant to submit to arbitration due to limited experience and lack of familiarity with this mechanism.⁷⁴ Article 25 Alternative B contains an arbitration clause modelled on, but which differs from, the one in the OECD MTC.⁷⁵

Time within which to apply for arbitration: As noted above, article 25(5)(b) of the OECD MTC provides that the unresolved issues must be presented for arbitration within two years from the date that the taxpayer first presented the case regarding inappropriate taxation by one of the states. The UN MTC provides for a three-year period, presumably due to developing countries' administrative incapacities to deal with MAP matters.⁷⁶

Who initiates arbitration? Under the OECD MTC the taxpayer has the right to request that the unresolved issues in the case must be submitted to arbitration.⁷⁷ In the UN MTC it is either of the competent authorities who are obliged to submit unresolved issues for arbitration — the taxpayer has no express right to participate in arbitration.⁷⁸ In effect, the case is submitted for arbitration if one competent authority wishes to have the case arbitrated. Referral of the unresolved issues to arbitration is mandatory and does not depend on the approval of the other competent authority. Thus, if both competent authorities do not want to have the case go to arbitration, they do not have to submit the case.⁷⁹

Finality of decision: Under the OECD MTC the arbitral decision is final and the competent authorities are bound to implement the arbitral

us-usa-tax-arbitration-idUSBRE8A006T20121125 (accessed 26 March 2015).

⁷³ UN Secretariat paper on alternative dispute resolution in taxation (note 47 above) para 40.

⁷⁴ *Ibid* para 23.

⁷⁵ *Ibid*.

⁷⁶ Art 25(5)(b), Alternative B of the UN MTC.

⁷⁷ Para 63 of the *Commentary on article 25(1) of the OECD MTC*.

⁷⁸ Para 12 of the *Commentary on article 25(5), Alternative B*.

⁷⁹ UN *Handbook on Selected Issues* (note 10 above) 331.

award within six months.⁸⁰ Under the UN MTC the competent authorities can deviate from the arbitral decision if they can reach an agreement within six months after the decision is rendered, as long as that solution is based on a common understanding concerning the application and interpretation of the treaty.⁸¹ Although the UN approach leaves greater power in the hands of the competent authority, it may result in delays and in MAP not being achieved.⁸²

Types of default arbitral decisions: As explained above, the default approach of arbitral decisions in the OECD MTC is the reasoned approach, whereas the approach in the UN MTC is the short form decision. The reasons for the latter approach presumably are that it speeds up the process and ensures fewer costs for developing countries. The disadvantages of the approach have been explained above.

How effective has MAP been in resolving treaty disputes?

At the time of writing of this article, the latest OECD statistics for the period 2006 to 2014 show that there are more MAP cases being opened than closed. Statistics reveal that at the end of the 2014 reporting period the total number of MAP cases reported by OECD member countries in 2014 was 5 423, an 18,77 per cent increase as compared to 2013 reporting.⁸³ By the end of 2013 there were 4 566 MAP cases recorded internationally.⁸⁴ Most MAP cases were among OECD member countries. Germany had the highest number of cases, amounting to 858; followed by the United States with 732 cases and France with 618 cases. Of the 1 910 new MAP cases initiated in 2013, only 197 cases were reported to have been completed in 2013.⁸⁵ These statistics show that while MAP is gaining consensus, there generally is slow progress in resolving MAP

⁸⁰ Paras 18 and 19 of the *Commentary on article 25(5) OECD MTC*.

⁸¹ Art 25(5), Alternative B of the UN MTC; para 81 of the *Commentary on article 25(5) (Alternative B) of the UN MTC*.

⁸² UN *Handbook on Selected Issues* (note 10 above) 330.

⁸³ OECD 'Mutual agreement procedure statistics for 2014', available at <http://www.oecd.org/ctp/dispute/map-statistics-2014.htm> (accessed 13 May 2016). At the end of the 2013 reporting period, the total number of open MAP cases reported by OECD member countries was 4 566, a 12,1 per cent increase as compared to the 2012 reporting period and a 94,1 per cent increase as compared to the 2006 reporting period.

⁸⁴ OECD 'Mutual agreement procedure statistics for 2012', available at <http://www.oecd.org/ctp/dispute/mapstatistics2012.htm> (accessed 20 November 2016).

⁸⁵ *Ibid*; see also J-P Lieb 'Arbitration today' *International Arbitration in Tax Matters: Taking the Debate Forward* (Global Tax Policy Centre, Vienna University of Economics and Business, 18 January 2016) slide 4, available at https://www.wu.ac.at/.../jeanpierre_lieb_on_current_trends_in_arbitration.ppt (accessed 29 February 2016).

cases internationally, as the duration of resolving MAP cases remains quite long.⁸⁶

Data on MAP in non-OECD countries is not often made public and the general impression is that MAP is not widely used in these countries.⁸⁷ The secrecy built into the MAP process makes it difficult to get data on the number of MAP cases globally. Individual countries know the number of cases in which they are involved but these figures are not made public.

Measures taken by the OECD to ensure MAP is effective

Over the years the OECD has carried out work to determine the effectiveness of MAP. The OECD's initial work on MAP was its 2004 report entitled 'Improving the Process for Resolving International Tax Disputes',⁸⁸ which made recommendations on resolving cross-border tax disputes. Following this report, in 2006 the OECD issued a public discussion draft entitled 'Proposals for improving mechanisms for the resolution of tax treaty disputes',⁸⁹ which suggested the addition of an arbitration provision to the MAP process in the draft changes to the OECD MTC, as well as a proposal for developing an online Manual on Effective Mutual Agreement Procedure.⁹⁰ This discussion draft culminated in the 2007 report on 'Improving the resolution of tax treaty disputes'⁹¹ and the development of a 'Manual on effective Mutual Agreement Procedures'⁹² (MEMAP), which contains information on the operation of MAP and best practices of MAP. Despite these initiatives, there were still concerns about the effectiveness of MAP in resolving treaty disputes. At a 2012 OECD Roundtable on Dispute Resolution⁹³ practitioners raised concerns about: the impediments to access MAP, the ineffectiveness of MAP in multilateral cases, the limited number of arbitration provisions included in tax treaties, and various MAP procedural issues.⁹⁴ The OECD

⁸⁶ Zaimaj 'Dispute avoidance and resolution' (note 6 above) 280.

⁸⁷ Ibid.

⁸⁸ OECD *Improving the process for resolving international tax disputes* (note 42 above).

⁸⁹ OECD *Proposals for improving mechanisms for the resolution of tax treaty disputes* (2006).

⁹⁰ OECD *Improving the process for resolving international tax disputes* (note 42 above).

⁹¹ OECD *Improving the resolution of tax treaty disputes* (2007), available at <http://www.oecd.org/ctp/dispute/38055311.pdf> (accessed 17 March 2016)

⁹² OECD *Manual on effective Mutual Agreement Procedures* (2007), available at <https://www.oecd.org/ctp/38061910.pdf> (accessed 17 March 2016).

⁹³ OECD *Obstacles that prevent countries from resolving treaty related disputes under the mutual agreement procedure* (16 September 2015) para 7.

⁹⁴ Ibid.

recognised that effective and efficient dispute resolution mechanisms are of crucial importance for the functioning of tax treaties and that improving the functioning of MAP procedures, such as the inclusion of arbitration, required urgent attention.⁹⁵ In 2013 the OECD issued a report⁹⁶ that identified the following obstacles to MAP.

Practical and administrative issues: The OECD noted that many of the obstacles to MAP are of a procedural, practical or administrative nature. Examples included lack of resources, inadequate empowerment of competent authorities to reach principled case resolutions and the lack of mutual trust among competent authorities.⁹⁷ The OECD indicated that addressing these challenges would require changes to: the OECD MTC, the OECD MEMAP⁹⁸ as well as to Chapter IV of the OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations', which deals with administrative approaches to avoiding and resolving transfer pricing disputes.⁹⁹ The OECD formed the 'Forum on Tax Administration – MAP Forum' (FTA MAP Forum),¹⁰⁰ a meeting of competent authorities (currently comprising 25 countries), which focuses on empowering competent authorities to ensure they have adequate resources and to provide oversight over the individuals negotiating settlements under the MAP.¹⁰¹

Unilateral denial of access to MAP: Notwithstanding article 25(1), some countries unilaterally refuse to enter into MAP if they are of the view that a taxpayer has engaged in fraud or tax avoidance schemes in respect to which MAP is sought.¹⁰² Concerns have also been raised about countries, such as India, which deny tax benefits under domestic law that are available under the treaty.¹⁰³ The Indian legislation, however, is becoming more aligned to international norms, even though these changes are not always implemented by revenue officers.¹⁰⁴ To address these issues, the OECD proposed that the circumstances under which a taxpayer should be denied access to MAP should be analysed by both

⁹⁵ OECD *Obstacles to resolving treaty related disputes* (note 93 above) para 9.

⁹⁶ *Id* paras 4, 16.

⁹⁷ *Id* para 4.

⁹⁸ OECD *Manual on effective Mutual Agreement Procedures* (note 92 above).

⁹⁹ OECD *Obstacles to resolving treaty related disputes* (note 93 above) para 17.

¹⁰⁰ OECD Forum on Tax Administration *Mutual Agreement Procedure forum*, available at <http://www.oecd.org/site/ctpf/ftaworkprogramme201213.htm> (accessed 19 November 2016)

¹⁰¹ M Herzfeld 'Beyond BEPS: The problem of double taxation' *Tax Analysts* (10 February 2014) 1.

¹⁰² Para 26 of the *Commentary on article 25 of the OECD MTC*; OECD *Obstacles to resolving treaty related disputes* (note 93 above) para 19.

¹⁰³ Herzfeld 'Beyond BEPS: The problem of double taxation' (note 101 above) 1.

¹⁰⁴ *Ibid*.

contracting states, so as to come up with appropriate practices that take into account the differing domestic law circumstances in the countries concerned.¹⁰⁵ This proposal resulted in the addition of paragraphs 26 to 29 to the Commentary on Article 25 in 2008, which provides that even though a taxpayer is assessed for tax as a result of a domestic anti-avoidance regulation this does not justify a denial of access to MAP. This change is in line with article 27 of the Vienna Convention on the Law of Treaties (1969) which provides that a party may not invoke the provisions of domestic law as justification for its failure to comply with the conditions of a treaty.

Lack of an arbitration provision in the majority of treaties: Although a number of countries (mainly developed countries) have re-negotiated their older treaties and have added arbitration clauses,¹⁰⁶ because the article 25(5) arbitration provision was only added to the OECD MTC in 2008, the majority of the treaties concluded by countries before 2008 have not been re-negotiated to include an arbitration provision.¹⁰⁷ There are also many treaties concluded after 2008 that have the 'classic MAP' procedure without the arbitration provision.¹⁰⁸ Australia, for instance, has been reluctant to incorporate arbitration clauses in any of its tax treaties.¹⁰⁹ The OECD is committed to finding the reasons why countries have failed to include mandatory binding arbitration provisions in their recent tax treaties.¹¹⁰ One reason is that in some countries domestic law does not permit the MAP decision to override a court decision. This practice implies that such states would not be able effectively to implement arbitration decisions.¹¹¹ Another reason could be because of a footnote to the Commentary on article 25(5) which states, due to

¹⁰⁵ OECD *Obstacles to resolving treaty related disputes* (note 93 above) para 19.

¹⁰⁶ UN *Handbook on Selected Issues* (note 10 above) 331.

¹⁰⁷ OECD *Obstacles to resolving treaty related disputes* (note 93 above) para 31.

¹⁰⁸ *Ibid*; UN *Secretariat paper on alternative dispute resolution in taxation* (note 47 above) 9.

¹⁰⁹ M Lang et al (eds) *Multilateral Tax Treaties: New Developments in International Tax Law* (1998) 160.

¹¹⁰ OECD *Obstacles to resolving treaty related disputes* (note 93 above) para 35.

¹¹¹ Para 65 of the *Commentary on article 25* explains: 'It is recognised, however, that in some States, national law, policy or administrative considerations may not allow or justify the type of arbitration process provided for in the paragraph. For example, there may be constitutional barriers preventing arbitrators from deciding tax issues. In addition, some countries may only be in a position to include this paragraph in treaties with particular States. For these reasons, the paragraph should only be included in the Convention where each State concludes that the process is capable of effective implementation'. See also para 9 of the *Commentary on article 25 of the OECD MTC* reproduced in para 9 of the *Commentary on article 25 of the UN MTC*.

the difficulties in some countries regarding the interrelationship between MAP decisions and domestic court decisions, that countries are free to exclude arbitration from their treaties.¹¹² The OECD supposes that as states become more familiar with arbitration, the considerations reflected in the footnote and Commentary should no longer be a reason to prevent the inclusion of arbitration provisions in tax treaties.¹¹³

The OECD recommends that even where contracting states have not included an arbitration clause in their convention it is still possible for them (if they so wish) to implement an arbitration process for general application or to deal with a specific case, by mutual agreement.¹¹⁴ In this regard some countries, for instance, have agreed to insert a provision in their treaties that do not have arbitration clauses that, if the treaty partner enters into a treaty with another state which has an arbitration clause, an arbitration clause must be included in the existing treaty without further formalities being required.¹¹⁵ In other instances countries have entered into what is termed 'optional arbitration', which does not oblige a state to submit a case for arbitration except if both competent authorities and the taxpayer agree to do so. Optional arbitration, for instance, has been applied in the treaties that Italy and Canada have signed with some African countries.¹¹⁶ In other treaties, even though article 25(2)(b) provides that a person may present a case for arbitration within two years, the treaties may or may not set a time limit as to when the arbitration process may start if agreement has not been reached.¹¹⁷ One way to encourage developing countries to sign arbitration clauses is to create the option of arbitration without forcing them into it.

The OECD acknowledges that, in developing instruments and approaches to address obstacles to MAP, the differences in the dynamics between MAP with and MAP without arbitration need to be recognised.

¹¹² The quoted footnote states: 'In some States, national law, policy or administrative considerations may not allow or justify the type of dispute resolution envisaged under this paragraph. In addition, some States may only wish to include this paragraph in treaties with certain States. For these reasons, the paragraph should only be included in the Convention where each State concludes that it would be appropriate to do so. However, other States may be able to agree to remove from the paragraph the condition that issues may not be submitted to arbitration if a decision on these issues has already been rendered by one of their courts or administrative tribunals'.

¹¹³ OECD *Obstacles to resolving treaty related disputes* (note 93 above) para 34.

¹¹⁴ Para 69 of the *Commentary on article 25(5) of the OECD MTC*.

¹¹⁵ UN *Handbook on Selected Issues* (note 10 above) 331.

¹¹⁶ M Hearson 'The tax treaty arbitrators cometh' (21 September 2015) 2, available at <https://martinhearsen.wordpress.com/2015/09/21/the-tax-treaty-arbitrators-cometh/> (accessed 4 April 2016).

¹¹⁷ A Miller & L Oats *Principles of International Taxation* 4 ed (2014) chapter 7.

This recognition would require clarification of the circumstances in which access to MAP with an arbitration clause is permitted, as well as identifying the types of MAP cases where governments provide access to MAP but exclude the arbitration procedure.¹¹⁸ The OECD is committed to work on clearly articulating the circumstances under which a state – in a manner consistent with its treaty obligations under article 25 and the principles of treaty interpretation in the Vienna Convention on the Law of Treaties – may justifiably deny a taxpayer access to arbitration under the MAP.¹¹⁹

OECD/G20 BEPS Project: Action 14 – Make dispute resolution mechanisms more effective

When the OECD issued its 2013 ‘Action plan on Base Erosion and Profit Shifting’ (BEPS),¹²⁰ it emphasised that the need to effectively resolve treaty disputes was paramount as the initiatives to address BEPS would lead to the development of a broad range of new domestic law and treaty-based anti-abuse rules, which may be susceptible to conflicting interpretation.¹²¹ In Action 14 (of the 15-point action plan to address BEPS¹²²), entitled ‘Make dispute resolution mechanisms more effective’, the OECD notes that efforts to counter BEPS must be complemented with actions to improve the effectiveness of MAP so as to ensure certainty and predictability for business.¹²³ Action 14 recognises that the BEPS project will change the face of international taxation. At present, multinational enterprises are protected against double taxation by unilateral and tax treaty provisions,¹²⁴ their own tax-planning strategies or by manipulating gaps in the domestic tax laws of the jurisdictions in which they operate. When these strategies are dismantled through the introduction of BEPS measures, the pressure to resolve double taxation disputes will rise. Since it is difficult, if not impossible, to design rules that are open to only one interpretation, it is very likely that the pressure on the dispute resolution

¹¹⁸ OECD *Obstacles to resolving treaty related disputes* (note 93 above) para 10.

¹¹⁹ *Id* para 24.

¹²⁰ BEPS refers to tax planning strategies by mainly multinational enterprises that exploit gaps and mismatches in tax laws and double tax agreements of different jurisdictions to erode countries’ tax bases or shift profits to low tax jurisdictions where there is little or no economic activity. See OECD ‘About BEPS and the inclusive framework’, available at <http://www.oecd.org/tax/beps-about.htm> (accessed 4 June 2016).

¹²¹ OECD *Obstacles to resolving treaty related disputes* (note 93 above) para 22.

¹²² OECD *Addressing Base Erosion and Profit Shifting* (2013) 7–8.

¹²³ OECD *Action Plan on Base Erosion and Profit Shifting* (2013) 23

¹²⁴ Art 23 of the OECD MTC which provides for the methods of relieving double taxation.

mechanisms that are included in tax treaties will grow significantly.¹²⁵ Action 14 called on countries to make dispute resolution mechanisms more effective and to develop solutions to MAP obstacles.¹²⁶ In the 2015 Final Report on Action 14, OECD/G20 countries committed to implement a minimum standard on dispute resolution and a monitoring mechanism with respect to the same. They also developed MAP best practices and some OECD countries committed themselves to mandatory binding arbitration.¹²⁷ These matters are explained in some detail below.

The minimum standard on dispute resolution

The elements of the minimum standard are intended to fulfil the following three general objectives. First, countries should ensure that MAP is fully implemented in good faith and that MAP cases are resolved in a timely manner;¹²⁸ they should provide access to MAP in transfer pricing cases and make appropriate adjustments under article 9(2),¹²⁹ provide access to MAP in cases of treaty abuse,¹³⁰ commit to a timely resolution of MAP cases,¹³¹ enhance competent authority relationships and work collectively to improve the effectiveness of the MAP by becoming members of the OECD's FTA MAP Forum,¹³² provide timely and complete reporting of MAP statistics pursuant to an agreed reporting framework to be developed by the FTA MAP Forum,¹³³ commit to have their compliance with the minimum standard reviewed by their peers under the FTA MAP Forum,¹³⁴ and provide transparency with respect to their positions on MAP arbitration.¹³⁵

Second, countries should ensure that administrative processes promote the timely resolution of treaty-related disputes.¹³⁶ They should

¹²⁵ OECD *Obstacles to resolving treaty related disputes* (note 93 above) para 6.

¹²⁶ OECD *Action plan on Base Erosion and Profit Shifting* (note 123 above) 23.

¹²⁷ OECD/G20 2015 *Final Report on Action 14* (note 11 above) para 4.

¹²⁸ *Id* para 9.

¹²⁹ *Id* paras 11–13.

¹³⁰ Paras 9.1 to 9.5 of the *Commentary on article 1*.

¹³¹ OECD/G20 2015 *Final Report on Action 14* (note 11 above) para 18.

¹³² The FTA MAP Forum is a subsidiary body of the OECD Committee on Fiscal Affairs, which brings together commissioners from 46 countries to develop on an equal footing to deliberate on matters pertaining to MAP that affect all participants and to develop a multilateral strategic plan to collectively improve the effectiveness of the MAP in order to meet the needs of both governments and taxpayers and so assure the critical role of the MAP in the global tax environment. See OECD/G20 2015 *Final Report on Action 14* (note 11 above) para 19.

¹³³ *Id* para 20.

¹³⁴ *Id* para 21.

¹³⁵ See the factors described in para 65 of the *Commentary on article 25*.

¹³⁶ OECD/G20 2015 *Final Report on Action 14* (note 11 above) para 24.

publish rules, guidelines and procedures on how to access and use MAP and they should make such information available to taxpayers;¹³⁷ promote the transparency and dissemination of their MAP programme by publishing their country MAP profiles on a shared public platform developed in co-ordination with the FTA MAP Forum;¹³⁸ ensure that the staff in charge of the MAP processes have the authority to resolve MAP cases without the approval or the direction of the personnel who made the adjustments at issue, or being influenced by policy considerations that the country would like to see reflected in future amendments to the treaty;¹³⁹ not use staff performance indicators, that are based on the amount of sustained audit adjustments or maintaining tax revenue, to determine the performance of staff in charge of MAP;¹⁴⁰ ensure that adequate resources are provided for MAP functions;¹⁴¹ and clarify in their MAP guidance that audit settlements between tax authorities and taxpayers do not preclude access to MAP.¹⁴²

Third, countries should ensure that taxpayers that meet the requirements of article 25(1) can access MAP.¹⁴³ They should publish MAP guidance that specifies the information and documentation that a taxpayer is required to submit when they request MAP;¹⁴⁴ and ensure that the MAP agreement reached shall be implemented notwithstanding any time limits in their domestic laws.¹⁴⁵

The framework for a monitoring mechanism

The requirements of the minimum standard will result in certain changes to the OECD MTC.¹⁴⁶ OECD/G20 countries agreed to establish a peer-based monitoring mechanism under the FTA MAP Forum¹⁴⁷ to ensure that the commitments contained in the minimum standards are effectively satisfied.¹⁴⁸

¹³⁷ Id para 25.

¹³⁸ Id para 26.

¹³⁹ Id para 27.

¹⁴⁰ Id para 28.

¹⁴¹ Id para 29.

¹⁴² Id para 33.

¹⁴³ Id para 34.

¹⁴⁴ Id para 37.

¹⁴⁵ In light of art 15(2); OECD/G20 2015 *Final Report on Action 14* (note 11 above) para 43.

¹⁴⁶ OECD/G20 2015 *Final Report on Action 14* (note 11 above) para 5.

¹⁴⁷ Ibid.

¹⁴⁸ Id para 3.

MAP best practices recommended by the OECD

Action 14 recommends certain best practices to deal with the obstacles to MAP. Unlike the minimum standards, the best practices have not been committed to by all countries but it is hoped they will facilitate convergence of national practices and in future could become minimum standards.¹⁴⁹ The recommended best practices are to include article 9(2) in tax treaties, so as to prevent economic double taxation,¹⁵⁰ and MAP agreements reached between the competent authorities in terms of article 25(3) should be published.¹⁵¹ They are to develop 'global awareness' of the audit/examination functions involved in international matters by ensuring their personnel attend the Forum on Tax Administration's 'Global Awareness Training Module',¹⁵² and implement bilateral advance pricing agreement (APA) programmes which are instrumental in resolving transfer pricing disputes.¹⁵³

They should permit taxpayer requests for MAP for multiple years for recurring issues with respect to filed tax years where the relevant facts and circumstances have been verified on audit,¹⁵⁴ and suspend tax collections during the MAP process as taxpayers may face financial difficulties and double taxation if both states collect the disputed taxes and competent authorities may also find it difficult to enter into MAP discussions in good faith if they have to refund taxes already collected.¹⁵⁵ In addition, they should implement administrative measures to facilitate taxpayer recourse to the MAP, recognising that the choice of remedies

¹⁴⁹ Id para 7.

¹⁵⁰ Id para 44. Many countries do not have art 9(2) in their treaties; however, the article is instrumental in ensuring proper allocation of the income of multinational enterprises (MNEs) involved in transfer pricing. To prevent transfer pricing, the arm's length in art 9(1) is applied, whereby an adjustment has to be made by the tax authority to ensure the price charged by the MNE to its connected parties is in line with an arm's length price. Art 9(2) of the OECD MTC aims to compensate the income adjustment of a contracting state by an appropriate adjustment by the other contracting state ('corresponding adjustment') thus preventing economic double taxation which is not in accordance with the spirit of the convention. See para 2 of the *Commentary on article 9(2) of the OECD MTC*.

¹⁵¹ OECD/G20 2015 *Final Report on Action 14* (note 11 above) para 45.

¹⁵² Id para 46.

¹⁵³ Id para 48. APAs are arrangements that open up a possibility for enterprises to get approval in advance by the tax authorities of the pricing method to be applied in controlled transactions. For details see AW Oguttu 'Resolving transfer-pricing disputes: Are "advance pricing agreements" the way forward for South Africa?' (2006) 18 *SA Mercantile Law Journal* 460.

¹⁵⁴ OECD/G20 2015 *Final Report on Action 14* (note 11 above) para 49.

¹⁵⁵ Id para 50.

remains with the taxpayer.¹⁵⁶ They should publish MAP guidance on the following issues: to clarify the relationship between MAP and domestic law administrative and judicial remedies, in particular, whether the competent authority (CA) is legally bound to follow a domestic court decision instead of the MAP decision; to permit taxpayers to access MAP in the case of *bona fide* taxpayer-initiated foreign adjustments that are permitted under the domestic laws of a treaty partner which allow a taxpayer to amend a previously-filed tax return and to adjust (i) the price for a transaction between associated enterprises or (ii) the profits attributable to a permanent establishment, with a view to reporting a result that is, in the view of the taxpayer, in accordance with the arm's length principle; to specify applicable interest and penalties with respect to MAP; and to give guidance on multilateral MAPs and APAs.¹⁵⁷

Mandatory binding arbitration

The OECD acknowledges that the business community and a number of countries consider that mandatory binding arbitration is the best way of ensuring that tax treaty disputes are effectively resolved through MAP.¹⁵⁸ Thus the agreement to a minimum standard to make MAP more effective is complemented by a commitment by a number of countries to adopt mandatory binding arbitration. However, there is no consensus among all OECD and G20 countries on the adoption of mandatory binding arbitration.¹⁵⁹ By the time of the release of the 2015 Final Report on Action 14, only twenty of the OECD member countries had expressed interest in adopting and implementing mandatory binding arbitration as a way to resolve disputes.¹⁶⁰ Nevertheless, the OECD states that a mandatory binding MAP arbitration provision will be part of the negotiation of the multilateral instrument envisaged by Action 15 of the BEPS Project, which will alleviate the need to renegotiate the multitude of double tax treaties countries have in light of the changes that will affect tax treaty provisions as a result of the OECD BEPS Project.¹⁶¹

¹⁵⁶ Id para 51.

¹⁵⁷ Id para 52.

¹⁵⁸ Id para 62.

¹⁵⁹ Id para 8.

¹⁶⁰ These are: Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States. The OECD notes that this represents a major step forward as, together these countries were involved in more than 90 per cent of outstanding MAP cases by the end of 2014, as reported to the OECD. See OECD/G20 2015 *Final Report on Action 14* (note 11 above) para 62.

¹⁶¹ OECD *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties: Action*

MAP in developing countries in Africa

Due to a lack of capacity, and even capability, practically to manage the MAP process, developing countries barely participate in MAP. So MAP is largely underdeveloped and uncertain in these countries; therefore it is difficult to get MAP statistics for developing countries. The OECD website shows MAP statistics for only one African country – South Africa.¹⁶² South Africa's MAP statistics for 2007–2014 as adopted from the OECD website are as follows:¹⁶³

Year	Unresolved cases from previous year		New cases reported in the year		Cases resolved in the year	
	OECD	NON-OECD	OECD	Non-OECD	OECD	Non-OECD
2007	0	0	0	0	0	0
2008	0	0	3	1	3	1
2009	0	0	1	0	0	0
2010	1	0	2	3	1	1
2011	2	2	4	1	0	3
2012	3	3	1	2	1	2
2013	3	3	1	1	2	0
2014	2	4	4	0	2	0

Commenting on these statistics, Ernst and Young accounting firm noted that cases on international tax disputes in South Africa are increasing.¹⁶⁴ It was also noted that by 2011 South Africa had several pending cases on transfer pricing disputes but it had no precedents on MAP on transfer pricing.¹⁶⁵ However, MAP has been particularly underdeveloped in other African countries, despite the presence of regional organisations such as the African Tax Administration Forum

15: 2014 Deliverable (OECD/G20 Base Erosion and Profit Shifting Projects) paras 3–5.

¹⁶² OECD MAP statistics are available on the OECD website at <http://www.oecd.org/ctp/dispute/map-statistics-2006-2014.htm> (accessed 10 April 2016).

¹⁶³ OECD 'MAP statistics for South Africa', available at <http://www.oecd.org/ctp/dispute/MAP%20PROGRAM%20STATISTICS%20FOR%202014%20SOUTH%20AFRICA.pdf> (accessed 10 April 2016).

¹⁶⁴ Lieb 'Arbitration today' (note 85 above) 3.

¹⁶⁵ W Horak & J Kotze 'South Africa' in A Bakker & MM Levy (eds) *Transfer Pricing and Dispute Resolution* (2011) 587; Zaimaj 'Dispute avoidance and resolution' (note 6 above) 277.

(ATAF), which promotes and facilitates mutual cooperation among African tax administrators.¹⁶⁶ Many African countries are reluctant to commit to arbitration provisions mainly due to the secretiveness of the procedure.¹⁶⁷ The decision whether to include an arbitration clause in a treaty depends on policy and administrative considerations of each contracting state and its actual experiences with MAP. South Africa, which has the widest network on double treaties in Africa (having entered into 75 double tax treaties as at 31 March 2016),¹⁶⁸ has arbitration clauses in only three of its double tax treaties: its treaties with Canada,¹⁶⁹ the Netherlands¹⁷⁰ and Switzerland.¹⁷¹ South Africa has no arbitration provisions in the treaties it has signed with other African countries, which compounds the challenge of expediting any MAP cases that could arise with its African treaty partners. The table below, adopted from the 'International Bureau for Fiscal Documentation' (IBFD) database,¹⁷² shows the list of African countries with arbitration provisions in their tax treaties.

¹⁶⁶ ATAF 'About ATAF', available at <http://www.ataftax.org/en/about/Pages/Overview.aspx> (accessed 29 August 2016).

¹⁶⁷ Paras 3–5 of the *Commentary on article 25 of the UN MTC*.

¹⁶⁸ SARS 'Summary of all treaties for the avoidance of double taxation', available at <http://www.sars.gov.za/AllDocs/LegalDoclib/Agreements/LAPD-IntA-DTA-2013-01%20-%20Status%20Overview%20of%20All%20DTAs%20and%20Protocols.pdf> (accessed 28 May 2016).

¹⁶⁹ SARS *Convention between the Republic of South Africa and Canada for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income* (GN 675 in GG 17985 of 7 May 1997). The convention entered into force on 30 April 1997.

¹⁷⁰ SARS *Convention between the Republic of South Africa and the Kingdom of the Netherlands for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital government* (GN 34 in GG 31797 of 23 January 2009). The convention entered into force on 28 December 2008.

¹⁷¹ SARS *Convention between the Republic of South Africa and the Swiss Confederation for the avoidance of double taxation with respect to taxes on income* (GN 213 in GG 31967 of 6 March 2009). The convention entered into force on 27 January 2009.

¹⁷² IBFD 'Tax treaties data base', available at <http://www.ibfd.org/IBFD-Products/Tax-Treaties-Database> (accessed 16 August 2016). See also Hearson 'The tax treaty arbitrators cometh' (note 116 above) 16.

African country	Treaty partner	Year	Model Convention	Trigger for arbitration	Binding on CA
Algeria	Netherlands	2015	OECD MTC	Either state	Yes
Congo	Italy	2013		Both states	No
Egypt	Netherlands	1999		Either state	Yes
Ethiopia	Netherlands	2012		Taxpayer	Yes
Ghana	Italy	2004		Both states	Yes
Ghana	Netherlands	2008		Either state	Yes
Kenya	Netherlands	2015	OECD MTC	Taxpayer	Yes
Malawi	Netherlands	2015	OECD MTC	Taxpayer	Yes
Namibia	Canada	2010	OECD MTC	Both states	Yes
Rwanda	Jersey	2015	UN MTC	Either state	No
South Africa	Canada	1997		Both states	Yes
South Africa	Netherlands	2008		Either state	Yes
South Africa	Switzerland	2009		Either state	Yes
Uganda	Netherlands		OECD MTC	Taxpayer	Yes
Zambia	Netherlands	2015		Either state	No

The table above portrays that the Netherlands renegotiated most treaties with several African countries that include a binding arbitration clauses. Most arbitration clauses signed by African countries are based on the OECD MTC, even though the UN provisions are more advantageous to developing countries.¹⁷³ Research shows that arbitration clauses are of particular importance to jurisdictions whose treaty networks are used as part of tax planning strategies; the top ten such jurisdictions include the treaty networks of the Netherlands, Switzerland, Liechtenstein and Luxembourg.¹⁷⁴

Country	Treaties with arbitration clauses
Netherlands	41
Switzerland	40
United Kingdom	22
Canada	21
Italy	18
Mexico	15
Belgium	12
United States	12
Liechtenstein	12
Luxembourg	12

Developing country concerns about arbitration in tax treaties

Confidentiality of arbitral proceedings: Tax arbitral proceedings are currently confidential; there are no publicly available outcomes to MAP.¹⁷⁵ The reason for this is that taxpayers do not want to make their tax strategies public. It is also reasoned that confidentiality enables flexibility in achieving a mutually acceptable result between governments without any external influences.¹⁷⁶ However, the secrecy of MAP makes it difficult for countries to draw on the experience gained in a given case or to monitor the fairness and effectiveness of the arbitration process. The emphasis placed on confidentiality over transparency makes it difficult to develop confidence in the system since taxpayers cannot ascertain

¹⁷³ Ibid.

¹⁷⁴ Ibid.

¹⁷⁵ Paras 3–5 of the *Commentary on article 25 of the UN MTC*.

¹⁷⁶ Ibid.

if the same decision would be applied in other similar cases. It is thus important that data is released not only on the number of reported MAP cases but also on the length of the cases so that other governments and taxpayers are aware of any unresolved cases.

Selection of arbitrators: The OECD MTC provides limited guidance about the selection of arbitrators. In contrast, arbitration in trade agreements, such as under the World Trade Organisation (WTO), provides a list of arbitrators who have to be appointed according to certain criteria as well as information about the number of times an arbitrator has served in certain disputes and the countries involved.¹⁷⁷ Tax treaty arbitration under the OECD MTC does not guarantee the neutrality and independence of arbitrators. However, it is worth noting that the UN requires appointed arbitrators to certify their independence and impartiality.¹⁷⁸ It is no wonder that developing countries are sceptical about arbitration since it entails entrusting decisions involving millions of dollars to a secret and unaccountable procedure of third-party adjudication.

Lack of experience: It is acknowledged that over the years there has been an increased experience in arbitration and a rise in the number of skilled arbitrators from various backgrounds and regions: these include government officials, judges, academics and practitioners. Although some developing countries have gained experience in arbitration and even though some arbitrators come from developing countries,¹⁷⁹ most do not have that much experience of MAP. Experience in MAP issues has mainly been among developed countries. For instance, European Union (EU) countries have gained arbitration experience because of the EU Arbitration Convention which was formed in 1990 to: arbitrate transfer pricing cases, prevent double taxation and improve cross-border activities in the EU.¹⁸⁰ It should be noted though that referring to arbitration under the EU Arbitration Convention as a measure of the success of arbitration in general is not realistic, as the procedure works better among countries with a fairly equal ability to bear the costs and burdens of arbitration (e.g. EU countries), which may not be the case where the relevant

¹⁷⁷ WTO 'Panels' *Dispute Settlement System Training Module*, available at https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c3s3p1_e.htm (accessed 21 October 2015).

¹⁷⁸ UN *Handbook on Selected Issues* (note 10 above) 334.

¹⁷⁹ UN *Handbook on Selected Issues* (note 10 above) 330.

¹⁸⁰ EU Convention on the Elimination of Double Taxation in connection with the Adjustment of Profits of Associated Enterprises (90/463/EEC), available at http://ec.europa.eu/taxation_customs/taxation/company_tax/transfer_pricing/arbitration_convention/index_en.htm (accessed 12 March 2016).

abilities among countries differ significantly.¹⁸¹ Developing countries with limited arbitration experience tend to be sceptical,¹⁸² fearing that arbitration could turn out to be unfair to them when disputes occur with more experienced countries that have had many MAP cases. Countries with arbitration experience tend to know more about what appeals to particular arbitrators, whereas inexperienced countries may be forced to hire specialist counsel, which may not always work to their advantage.¹⁸³ There may be concerns that arbitrators from developed countries will not be impartial if a MAP case involves their own country.

Unfavourable treaties: Developing countries are wary of arbitration because most of the tax treaties they have signed are not in their favour; rather they reflect the favourable position of the other contracting state, especially if it is a developed country.¹⁸⁴ This situation is because the ability to negotiate favourable treaty provisions depends a lot on the treaty-negotiating power of the relevant country. Developed countries are better skilled in negotiating tax treaties than developing countries,¹⁸⁵ and in most treaty negotiations the balance of power is in favour of developed countries, with developing countries often being the price-takers. For these reasons developing countries have concerns that agreeing to arbitration with developed countries may make their position even worse, particularly when signing of treaties is politically driven with weak or nonexistent parliamentary ratification processes and little concern about the tax implications. It is also worth noting that many old double tax treaties that some developing countries have signed are ineffective in protecting their taxation rights due to changing tax systems, the growth of e-commerce, and the development of modern business models that emphasise intellectual property as a value driver, as well as the increase in treaty abuse schemes used by multinational enterprises to avoid taxes. For these reasons, developing countries argue that signing mandatory arbitration provisions reduces their ability to manoeuvre out of complex cases where latter-day tax treaties frustrate present-day policy goals.¹⁸⁶

¹⁸¹ UN Secretariat paper on alternative dispute resolution in taxation (note 47 above) para 27.

¹⁸² Hearson 'The tax treaty arbitrators cometh' (note 116 above) 1.

¹⁸³ UN Secretariat paper on alternative dispute resolution in taxation (note 47 above) para 99.

¹⁸⁴ F Akunobela 'The relevance of the OECD and UN Model Conventions and their Commentaries for the interpretation of Ugandan tax treaties' in M Lang et al (eds) *The Impact of the OECD and UN Model Tax Conventions on Bilateral Tax Treaties* (2012) 1075.

¹⁸⁵ PWC & EuropeAID *Transfer pricing and developing countries: Final report* (2011) 21.

¹⁸⁶ List adopted from Hearson 'The tax treaty arbitrators cometh' (note 116 above) 1.

No appeal or review of arbitral decisions: The fact that tax treaty arbitral decisions cannot be reviewed or appealed against explains developing countries' reluctance with regard to arbitration. This *lacuna* in tax treaty arbitration is unlike the case of arbitration under the WTO, where there are provisions¹⁸⁷ to ensure consistency in the approaches of the arbitral panels,¹⁸⁸ as well as an Appellate Body.¹⁸⁹ Even in the case of Bilateral Investment Agreements, arbitration proceedings are subject to scrutiny, for example, by the International Court of Arbitration.¹⁹⁰ Although an appeal mechanism can be viewed as costly in terms of time and resources, the lack of this mechanism in tax treaty arbitration creates a lack of confidence in the system.¹⁹¹

Concerns about tax sovereignty: Some countries consider that arbitration impacts on sovereignty in their tax affairs, in that arbitration goes beyond what the tax treaty intended as it requires giving too great a discretionary power to individuals who are third parties to the treaty, to decide treaty matters, without any checks and balances to the actions taken by such arbitrators. Thus, many countries find that it is not in their interest to limit their sovereignty in tax matters through mandatory arbitration.¹⁹²

The costs of arbitration: The logistical costs of arbitration are supposed to be borne by the countries concerned: these include the salaries of arbitrators, hiring facilities, hiring external advisors and counsel, the cost of organising arbitration proceedings, travelling costs, as well as costs for translating and preparing documents.¹⁹³ Paragraph 12 of the Commentary on article 25 of both the OECD and UN MTCs clarifies, unless agreed otherwise, that the competent authority to which the arbitration case 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

¹⁸⁷ WTO 'Developing countries in WTO dispute settlement' *Dispute Settlement System Training Module*, available at https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c11s2p2_e.htm (accessed 21 October 2015).

¹⁸⁸ WTO 'Panels' (note 177 above).

¹⁸⁹ WTO 'Appellate Body' *Dispute Settlement System Training Module*, available at https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c3s4p1_e.htm (accessed 21 October 2015).

¹⁹⁰ ICC 'Award and award scrutiny', available at <http://www.iccwbo.org/products-and-services/arbitration-and-adr/arbitration/icc-arbitration-process/award-and-award-scrutiny> (accessed 20 November 2016).

¹⁹¹ UN *Secretariat paper on alternative dispute resolution in taxation* (note 47 above) para 132.

¹⁹² UN *Handbook on Selected Issues* (note 10 above) 329.

¹⁹³ UN *Secretariat paper on alternative dispute resolution in taxation* (note 47 above) para 76.

arbitration process. Thus, in most cases, the dispute will be heard in the country where the case is first reported. For African countries, if arbitration takes place in its developed country counterpart, the costs can be quite prohibitive.¹⁹⁴ It is important that inability to bear the cost does not influence the outcome of the case. Developing countries should not be compelled to agree to an unfavourable outcome because they cannot afford the costs; this would bring into question the validity of the arbitration process.¹⁹⁵

The importance of effective dispute resolution in developing countries: The South Africa and Uganda experiences

The above concerns about MAP in general and arbitration in particular should not be construed to encourage developing countries to ignore international efforts to ensure effective resolution of treaty disputes. Even though data on MAP in developing countries is very limited, inventories on the same show increasingly that there are unresolved MAP cases involving developing countries.¹⁹⁶ The necessity of effective MAP in Africa can be exemplified by the following examples from South Africa and Uganda.

Ineffective MAP in South Africa's treaties with other African countries

South Africa has signed a number of tax treaties with other African countries. However, over the years, South Africa has been caught up in a situation where some African countries incorrectly were claiming source jurisdiction on management fees which were supposed to be taxable in South Africa.¹⁹⁷ These countries levied withholding tax on management fees for services received by South African residents even if the relevant tax treaty did not have an article on management fees¹⁹⁸ and even if no

¹⁹⁴ Ibid.

¹⁹⁵ Id para 78.

¹⁹⁶ Id 3.

¹⁹⁷ Explanatory Memorandum to the Taxation Laws Amendment Bill, 2015.

¹⁹⁸ Some countries have signed treaties with articles on management fees (often combined with service and technical fees) which currently deviate from the OECD and the UN MTCs. Generally there is no clear definition of such services but the treaties that have these articles broadly define services, management and technical fees as 'payments of any kind to any person, other than an employee of the person making the payments, in consideration for any services of a managerial, technical or consultancy nature, rendered in a contracting state'. For example, art 12(4) of the Ghana and Germany treaty.

permanent establishment¹⁹⁹ had been established in that country.²⁰⁰ This practice resulted in double taxation for South African taxpayers, contrary to the tax treaty and it made South Africa unattractive as a headquarter company location.²⁰¹ Ideally this matter should have been resolved using the MAP procedure. South African residents had little success in challenging the ensuing double taxation with the tax authorities of the other countries and the South African Revenue Service (SARS) did not enforce the proper application of the treaties with these countries.²⁰² In 2012, South African legislators came up with a temporary unilateral tax credit to prevent double taxation (section 6quin of the Income Tax Act 68 of 1962), which provided a rebate for management fees and technical service fees that had been paid in a foreign country. However, the application of this section implied that South Africa departed from the tax treaty principles in its treaties with the relevant countries, in that it gave them taxing rights over income not sourced in those countries. As a result, South Africa effectively eroded its own tax base as it was obliged to give credit for taxes levied in the other country. In effect, South Africa indirectly subsidised the countries that did not comply with the treaty.²⁰³ Consequently, section 6quin was repealed for the years commencing on or after 1 January 2016.²⁰⁴ However, concerns were raised by taxpayers that the withdrawal of section 6quin could undermine South Africa as a location for headquarters and could see banking, retail, and telecommunication companies relocating their headquarters elsewhere.²⁰⁵

To mitigate against double taxation a deduction is now granted under section 6quat(1C) of the Income Tax Act in respect of foreign taxes which are paid or proved to be payable without taking into account the option of

¹⁹⁹ The permanent establishment (PE) concept is provided for in art 5 of both the OECD and UN MTCs; it is generally defined in art 5(1) as a fixed place of business through which the business of the enterprise is carried on. The article also provides for a special PE rule for construction sites and also for deemed PEs in respect of dependent agents.

²⁰⁰ Explanatory Memorandum to the Taxation Laws Amendment Bill, 2015.

²⁰¹ In 2010 South Africa came up with a headquarter company regime to make the country a potential location for foreign investments into the rest of Africa. See AW Oguttu 'Developing South Africa as a gateway for foreign investment in Africa: A critique of South Africa's headquarter company regime' (2011) 36 *South African Yearbook of International Law* 61.

²⁰² Explanatory Memorandum to the Taxation Laws Amendment Bill, 2015.

²⁰³ *Ibid.*

²⁰⁴ S 5 of the Draft Taxation Laws Amendment Bill, 2015.

²⁰⁵ 'MTN warns against removing African tax incentive' *BusinessDay* (17 September 2015), available at <http://www.bdlive.co.za/business/technology/2015/09/17/mtn-warns-against-removing-african-tax-incentive> (accessed 21 October 2015).

MAP. Thus, MAP is the forum that ought to be used to solve any ensuing treaty disputes.

MAP cases can involve significant amounts of revenue that African countries cannot afford to lose

One of the main reasons why it is necessary for African countries to understand the MAP and to ensure it is effective is that a single MAP case can involve very significant amounts of revenue that developing countries cannot afford to lose.²⁰⁶ These sums may be small relative to total tax revenue in developed economies, but they are large for developing countries that increasingly are involved in international tax cases.²⁰⁷ An example is the Ugandan case of *Zain International BV v Commissioner General of Uganda Revenue Authority*.²⁰⁸ In this case a dispute arose when Zain International BV (Zain) disposed of its shares in Zain Africa BV to Bharti Airtel International BV on 30 March 2010. All three companies are incorporated and resident in the Netherlands. Zain Africa BV had equity interests in 26 Dutch BV companies, among which was Celtel Uganda Holding BV that owned 99,99 per cent of Celtel Uganda Ltd. The Uganda Revenue Authority (URA) issued a tax assessment on Zain on the grounds that the gain arose from the disposal of an interest in immovable property located in Uganda in terms of article 13 of the DTA between Uganda and the Netherlands. The tax assessment amounted to 85 million dollars and penal interest at the rate of 2 per cent per month on the amount until paid in full. Zain contended, since it had sold its shares in the Netherlands to a Netherlands entity, that the income was sourced in the Netherlands and not in Uganda. The lower court, which did not consider the substantive tax treaty issues of the case, ruled that Uganda had no jurisdiction to tax Zain. However, the Court of Appeal ruled that Uganda had jurisdiction to tax proceeds on a sale of shares between two foreign companies involving the sale of assets in Uganda. The URA was given an opportunity to study the transaction again and determine what taxes to claim. However, Zain applied for MAP in the Netherlands²⁰⁹ in terms of article 25 of the DTA between

²⁰⁶ IMF *Spillovers in international corporate taxation* (2014) 5–6, available at www.imf.org/external/np/pp/eng/2014/050914.pdf (accessed 28 May 2016).

²⁰⁷ *Ibid.*

²⁰⁸ High Court of Uganda at Kampala (Civil Division) Miscellaneous Cause no 96 of 2011.

²⁰⁹ DK Kalinaki 'Court gives URA nod to seek taxes on sale of Zain assets in Uganda' *The East African* (13 September 2014), available at <http://www.theeastafrican.co.ke/news/URA-taxes-on-sale-of-Zain-assets-in-Uganda/-/2558/2451578/-/item/0/-/6hm2he/-/index.html> (accessed 22 July 2015).

Uganda and the Netherlands, which has an arbitration provision. Since the competent authority of the country where the case is presented for arbitration is the one responsible for the logistical arrangements of the arbitral panel meetings,²¹⁰ the Netherlands will be the venue for the arbitration proceedings. For a developing country, such as Uganda, if the arbitration proceedings take place in its developed country counterpart which has more resources and experience with arbitration, there is a lack of confidence about the impartiality of the proceedings. Given that Uganda lacks experience in MAP matters, it is a worry, if, having won an international tax case against an MNE for 85 million dollars, it ends up losing the case.

The impact of arbitration in Bilateral Investment Treaties on tax treaty disputes

Countries often sign Bilateral Investment Treaties (BITs) to protect investments by investors of one state in the other state. The BIT articulates the rules governing the host state's treatment of investments and it establishes dispute resolution mechanisms applicable to alleged violations of those rules.²¹¹ Often countries have BITs with the same countries with which they have signed DTAs. Typically, most countries' BITs have carve-out clauses for taxation matters.²¹² BITs also provide for investor-state arbitration, in that foreign investors can take the contracting states to international arbitration for breach of the terms of the treaty.²¹³ An investor is allowed to bring a dispute for settlement to any forum of his or her choice. Such forums include the International Centre for Settlement of Investment Disputes²¹⁴ or the International Chamber of Commerce.²¹⁵ In a situation where a taxpayer's country of residence has a DTA with a country that has no arbitration clause, and yet that country has a BIT with the investor country that has an arbitration clause, the taxpayer may seek to have the relevant dispute resolved under the BIT. This possibility highlights the need for ministries or departments in countries not to function in isolation but to understand the legal and tax implications of all the treaties they enter into. The interplay of BITs and

²¹⁰ Para 12 of the *Commentary on article 25 of the OECD MTC*.

²¹¹ KJ Vandeveldel 'The economics of bilateral investment treaties' (2000) 41 *Harvard International Law Journal* 469.

²¹² Para 89 of the *Commentary on article 25 of the OECD MTC*.

²¹³ *Ibid*.

²¹⁴ International Centre for Settlement of Investment Disputes *ICSID Conventions, Regulations and Rules* (2006) art 36, Chapter IV.

²¹⁵ ICC *ICC Rules of Arbitration* (2012).

tax treaties, for instance, impacted on the trajectory of two Ugandan tax cases discussed below.

In *Heritage Oil & Gas Limited v Uganda Revenue Authority*²¹⁶ the taxpayer sought arbitration under the BIT signed between Uganda and the United Kingdom (UK). The original tax case concerned the sale of immovable property in Uganda. In terms of a Joint Operating Agreement, Heritage Oil & Gas Ltd (Heritage) and Tullow Uganda Ltd (Tullow) entered into a Production Sharing Agreement with the Ugandan Government in respect of oil exploration in 2004. Heritage and Tullow got licences to explore, develop and produce petroleum in certain designated areas where oil was discovered. With consent from the government of Uganda and on condition that taxes would be paid, Heritage sold to Tullow its 50 per cent participation in the oil exploration licence. At that time Heritage was tax resident in Mauritius. The URA issued an assessment of US\$404 925 000 in respect of Heritage for capital gains tax on the sale of immovable property. The URA relied on section 79(g) of Uganda's Income Tax Act (ITA), Cap 340, which provides that income derived from the disposal of an interest in immovable property located in Uganda is sourced in Uganda. Heritage argued, as the ITA did not have a definition of immovable property, that the interest in immovable property was not taxable in Uganda. The court held that in terms of section 88 of the ITA,²¹⁷ the Uganda/Mauritius DTA forms part of the ITA and, since article 6 of the DTA provides that immovable property includes 'property accessory to immovable property', the proceeds from the disposal of immovable property were taxable in Uganda.

Since Heritage Oil is a UK-listed company and the UK has a BIT with Uganda, in 2012 Heritage Oil took the case for arbitration to London, under the United Nations Commission on International Trade Law, to decide whether it should pay the assessed capital gains tax. Uganda argued that tax matters were not an issue for arbitration because they were never part of its production-sharing agreement with Heritage Oil and further that the London tribunal did not have jurisdiction to handle tax matters. Civil society was outraged by the proceedings as many Ugandans did not understand why their government had to spend millions of pounds on a tax dispute in London when it had been decided by Uganda's courts.²¹⁸ If Heritage Oil won this case and did not pay the

²¹⁶ Uganda, Tax Appeals Tribunal Tax Application no 26 of 2010.

²¹⁷ Uganda's Income Tax Act, Cap 340.

²¹⁸ 'Heritage oil arbitration case in London deprives Ugandan citizens of right to information' *Global Witness*, available at <https://www.globalwitness.org/en/archive/heritage-oil-arbitration-case-london-deprives-ugandan-citizens-right-information/> (accessed 18 March 2016).

taxes due, there would be a deep sense of injustice in Uganda.²¹⁹ To the relief of the Ugandan government, in April 2013 the tribunal ruled in favour of Uganda, dismissing the objection filed by Heritage Oil & Gas against the multi-million dollar tax dispute.²²⁰

In the subsequent case of *Tullow Uganda Limited and Tullow Operational Pty Ltd v Uganda Revenue Authority*,²²¹ Tullow Uganda Limited and Tullow Operational Pty Ltd (the applicants) entered into a production-sharing agreement with the Ugandan government, under which the applicants were granted exploration, development and production rights in a certain Exploration Area. The production-sharing agreement, which was signed by the Mineral and Energy Development Minister, provided in article 23.5 that 'the assignment or transfer of an interest under this Agreement and any related Exploration or Production License shall not be subject to any tax, fee, or other impost levied either on the assignor or the assignee in respect thereof'. When the applicants sold a portion of their interests in the Exploration Area to China National Offshore Oil Company and Total E&P Uganda, URA (the respondent) assessed the applicants for US\$467 271 971 in capital gains tax. The applicants objected to the assessment claiming that article 23.5 of the production-sharing agreement granted them an exemption from capital gains tax. The URA contended that the provision was unlawful since article 152(1) of the Constitution of the Republic of Uganda (as last amended in 2005) provides that no tax shall be imposed except under the authority of an Act of Parliament. Uganda's Income Tax Act, Cap 340 specifies the taxes payable and the URA is mandated to collect those taxes. The Tax Tribunal ruled in favour of the URA and decided that article 23.5 of the production-sharing agreement was invalid under the tax laws of Uganda and that the applicants were not exempt from capital gains tax. The applicants appealed against the decision. Total E&P, to which the applicants sold the interests in the Exploration Area, was expected to pay stamp duty estimated at about \$30 million as a result of that sale. Since Total E&P's parent company is in the Netherlands and Uganda has a BIT with the Netherlands (which entered into force on 1 January 2003), Total E&P filed a request for arbitration before the International Centre for Settlement of Investment Disputes²²² claiming that the Ugandan government had unlawfully imposed on it stamp duty,

²¹⁹ Ibid.

²²⁰ 'Heritage Oil case: What London court decision means for Uganda' *Sunday Monitor* (6 April 2013), available at <http://www.monitor.co.ug/News/National/Heritage-Oil-case--What-London-court-decision-means-for-Uganda/-/688334/1740218/-/1148h1rz/-/index.html> (accessed 20 March 2016).

²²¹ Uganda, Tax Appeals Tribunal Application no 4 of 2011.

²²² *Total E&P Uganda BV v Republic of Uganda* ICSID Case no ARB/15/11.

since article 23.5 of the production-sharing agreement contained a tax waiver.²²³ As at the writing of this article the decision is still pending.

The Ugandan cases above show how taxpayers aggrieved by domestic court decisions can seek arbitration in BITs to resolve the disputes in their favour. To prevent the challenges that arise when taxpayers take tax treaty disputes to arbitration under BITs the OECD recommends, during tax treaty negotiations, contracting states include a provision in their tax treaties that ensures that issues relating to taxes are dealt with under MAP rather than through the dispute resolution mechanisms of BITs.²²⁴

UN guidance on MAP for developing countries

The discussion in the paragraphs above explained the OECD's recommendations to ensure the effectiveness of MAP. However, the OECD's recommendations generally are based on the interests and concerns of its member countries, and may not take into account the interests and administrative constraints of developing countries. In contrast, the UN has championed the case of developing countries. Even before the 2015 OECD BEPS Report on Action 14, in 2012, the UN issued a Guide to MAP for developing countries that have signed treaties based on the UN MTC.²²⁵ The Guide's primary focus is on the specific needs and concerns of developing countries and countries in transition. The Guide is very instrumental in providing best practices and procedures in structuring and implementing MAP for developing countries to follow to ensure effective MAP. In addition, the UN has a capacity-building initiative that seeks to provide countries that have little or no experience with MAP with a practical guide to the procedure.²²⁶ Although the UN Guide on MAP draws on the OECD MEMAP (referred to above), it is based on the provisions of the UN MTC and seeks to present the various aspects of MAP from the perspective of developing countries that have limited experience with MAP.²²⁷

The UN advises that, although in practice most MAP cases are initiated by taxpayers seeking relief from taxation that is not in accordance with

²²³ Z Tiberindwa 'Uganda's unending oil tax disputes: Will URA survive another Total disaster' *Ugandan Oil* (10 April 2015), available at <http://ugandaoil.co/2015/04/ugandas-unending-oil-tax-disputes-will-ura-survive-another-total-disaster/> (accessed 18 March 2016); 'Total seeks arbitration over Uganda tax dispute' *Reuters Africa* (31 March 2015), available at <http://af.reuters.com/article/energyOilNews/idAFL6N0WW4NE20150331?pageNumber=2&virtualBrandChannel=0> (accessed 20 March 2015).

²²⁴ Para 94 of the *Commentary on article 25 of the OECD MTC*.

²²⁵ *UN Guide to Mutual Agreement Procedure in tax treaties* (note 8 above).

²²⁶ *Ibid.*

²²⁷ *Ibid.*

the treaty, it is also important that the competent authorities take full advantage of the authority they have under article 25(3) of the UN MTC to ensure that they issue guidance and interpretations of general application on MAP, as this can prevent unnecessary disputes and allow taxpayers to better organise their affairs.²²⁸ The following discussion briefly highlights some of the UN recommendations in this regard.

Paragraph 92 of the UN Guide to MAP provides that for the MAP to function most effectively it should be transparent and accessible to taxpayers. This can be achieved by publicising the necessary forms, format and instructions as to how to begin the MAP request, the time deadlines which must be met as well as guidance on other formal requirements.²²⁹ Paragraph 49 of the UN Guide to MAP provides that competent authorities should make every effort to resolve each case on a principled and fair basis; taking into consideration the facts and circumstances of the case as well as the applicable legal and economic principles. Competent authorities should ensure that their MAP process achieves a solution to the case and does not merely attempt to find the most advantageous resolution from a revenue point of view.²³⁰ The UN notes that some jurisdictions have a practice of including, in an audit settlement, an agreement that requires the taxpayer not to seek MAP relief after the settlement. This implies that the other tax administration would be excluded from considering the case, and encourages inappropriate principles for settling disputes, which impedes co-operation among competent authorities.²³¹ Paragraph 80 of the UN Guide to MAP provides that audit settlements should not require taxpayers to relinquish subsequent recourse to a MAP. Since the principal focus of an auditor in relation to the taxpayer is to collect revenue, whereas the function of MAP is to resolve treaty disputes, paragraph 62 of the UN Guide recommends that there should be a separation between MAP functions and audit functions. The UN Guide also encourages the use of advance pricing programmes as a means of resolving transfer pricing disputes.²³²

From the above, it is clear that in general the guidance provided by the UN in its 2012 Guide to MAP is in line with the OECD 2015 BEPS Report on Action 14. The UN also refers to the use of other supplementary dispute resolution mechanisms to improve the MAP, which include the

²²⁸ UN *Handbook on Selected Issues* (note 10 above) 327.

²²⁹ *Id* 324.

²³⁰ *Ibid*.

²³¹ Para 86 of the *Commentary on article 25 of the OECD*; UN *Handbook on Selected Issues* (note 10 above) 327.

²³² UN *Guide to Mutual Agreement Procedure in tax treaties* (note 8 above) para 230.

use of mediation and conciliation.²³³ In mediation, a mediator facilitates the negotiations between the competent authorities. In conciliation, the conciliator is more active than in mediation and may also make recommendations about the resolution.²³⁴ It should be noted though that these mechanisms have the risk of prolonging the dispute-resolution process and making the proceedings more costly. However, measures could be put in place to ensure accelerated conciliation or mediation procedures so that the costs are minimised.

Conclusions and recommendations

Countries often sign double tax treaties to alleviate impediments to international trade when their residents carry out business transactions between two contracting states. Even though tax treaties allocate taxing rights between the two contracting states and prevent double taxation by restricting the tax claims of the contracting states, inevitably disputes will arise as to whether tax was levied in accordance with the treaty. Although article 25 of treaties based on both the OECD and UN MTCs provides for the MAP as the mechanism for resolving tax treaty disputes, internationally, progress in ensuring effective MAP has been slow and MAP is largely undeveloped in developing countries. This article explains the challenges to the effectiveness of MAP, with particular emphasis on developing countries in Africa, using examples from South Africa and Uganda. Having considered the OECD and UN guidelines to ensure effective MAP, the following recommendations are provided to ensure that MAP develops in Africa.

On the international level: Although the inclusion of binding mandatory arbitration provisions in the MAP is being pushed by the OECD to ensure speedy resolution of tax treaty disputes, it is important to ensure that MAP in general and arbitration in particular are perceived by developing countries as fair so that they can commit to its implementation. Global solutions for effective dispute resolution should consider the concerns of developing countries, not only those of developed countries. It took many years to build consensus among OECD countries for arbitration to be introduced in the MTC and, as explained above, up to now many OECD countries do not have an arbitration provision in their tax treaties. Developing countries should be given time to assess whether binding arbitration is suitable for them: they should not prematurely be forced to participate in binding arbitral systems but should be left to make

²³³ UN Secretariat paper on alternative dispute resolution in taxation (note 47 above) 14.

²³⁴ Ibid.

their own decision on the appropriateness of arbitration in the light of their situation, experience and priorities.²³⁵ A way to encourage developing countries to sign arbitration clauses is to create the option of arbitration without forcing them, as is the case in the treaties that Italy and Canada signed with African countries (referred to above).²³⁶ The arbitral process should be made transparent. Keeping tax arbitration proceedings secret is not progressive. Civil society has a great interest in seeing that the tax system is transparent and that MNEs pay their fair share of taxes. Taxpayers are also interested in ensuring they are not treated less favourably than other taxpayers. To ensure confidence in the system there should be publication of reasoned decisions, in a redacted manner, that preserves any confidentiality concerns of the parties. Such redacted publication would provide precedents on how to find solutions to future problems.²³⁷ Confidence in the arbitral process could be achieved by setting up a global tax body, preferably under the auspices of the UN, with a tax tribunal to preside over all MAP cases.²³⁸ The decisions of such a tribunal would be considered neutral and fair to the interests of all countries. The tax tribunal could set up an international pool of arbitrators that comprises members from both developing and developed countries. Consideration should be given to developing a framework of options for developing countries wishing to improve their dispute settlement of international tax issues, in a way that is in line with their respective situation, realities and priorities.²³⁹ As the UN Guide on MAP for developing countries recommends, this may require not only considering arbitration but also other non-binding alternative dispute mechanisms such as mediation and conciliation, which are applied in resolving commercial disputes.²⁴⁰

At the regional level: The African Tax Administration Forum (ATAF)²⁴¹ should play a role in ensuring that MAP is effective among its member countries,²⁴² which commit to enforcing their treaty obligations and

²³⁵ UN Secretariat paper on alternative dispute resolution in taxation (note 47 above) 5.

²³⁶ Hearson 'The tax treaty arbitrators cometh' (note 116 above) 2.

²³⁷ UN Secretariat paper on alternative dispute resolution in taxation (note 47 above) para 124.

²³⁸ *Id* para 176.

²³⁹ *Id* 5.

²⁴⁰ *Ibid*.

²⁴¹ For details on ATAF visit <http://www.ataftax.org/en/Pages/default.aspx> (accessed 28 May 2016).

²⁴² As of May 2016, there are 37 ATAF member nations: Angola; Benin; Botswana; Burkina Faso; Burundi; Cameroon; Chad; Comoros; Côte d'Ivoire; Egypt; Eritrea; Gabon; Gambia; Ghana; Kenya; Lesotho; Liberia; Madagascar; Malawi; Mauritania; Mauritius; Mozambique; Namibia; Niger; Nigeria; Rwanda; Senegal;

ensuring that taxpayers can access MAP. MAP results and agreements reached among ATAF member countries should be made public in a redacted manner to provide guidance for future cases. The exchange of existing best practices between ATAF member countries should be strongly encouraged. ATAF should play a role in training African arbitrators, who would be instrumental in disputes involving African countries since they would understand the administrative and economic constraints these countries face.

At the national level: As more tax treaties are concluded by African countries the need to resolve disputes effectively is going to become increasingly important. Even though countries' tax treaties may have an article on MAP to resolve disputes, the actual implementation of the same between the two contracting states is what matters. Disputes cannot be resolved if enforcement is ineffective. African countries need to ensure that MAP functions effectively, that it is transparent and accessible to taxpayers. African tax administrations should set aside funds to train their staff on MAP. They should be more active in supporting taxpayers who apply for MAP. They should not influence taxpayers to waive their right to MAP; neither should taxpayers be prohibited, as part of settlement negotiations with tax administrations, from claiming the full tax suffered in exchange for not proceeding with MAP. In line with international guidance on effective MAP that has been provided by the OECD in Action 14 of its BEPS Report and the UN Guide on MAP for developing countries, African countries should publish guidelines and procedures to access MAP that clearly specify: the circumstances under which MAP will be applied, the applicable time limits in which a taxpayer can approach the competent authority, who the competent authority is, what documents are required to be submitted with the application for MAP, the interaction of MAP with domestic legislation and estimated timelines.

Following the above recommendations at the international, regional and national levels will play a great role in ensuring effective MAP in Africa.

Seychelles; Sierra Leone; South Africa; Sudan; Swaziland; Tanzania; The Gambia; Uganda; Zambia and Zimbabwe. See ATAF 'Member countries', available at http://crm.ataftax.org/member_countries_pub.php (accessed 28 May 2016).