

March 3, 2006

OECD Proposals for Improving Mechanisms for the
Resolution of Tax Treaty Disputes

Comments of the Securities Industry Association

The Securities Industry Association ("SIA")¹ is pleased to comment on the OECD's "Proposals for Improving Mechanisms for the Resolution of Tax Treaty Disputes."

SIA commends the OECD for its proposal to introduce binding arbitration as a means to resolve tax treaty disputes that competent authorities ("CAs") are unable to resolve through the Mutual Agreement Procedure ("MAP"). SIA strongly supports the view that arbitration will be a useful complement to MAP in promoting the resolution of tax treaty disputes. The ability of taxpayers to initiate arbitration of cases that are unresolved after two years of MAP will both increase the likelihood that cases will be resolved in MAP and afford the taxpayer and governments the certainty of a definitive ruling by an impartial tribunal in the event they are not.

To secure these benefits, Article 25, paragraph 5 and the related Commentary should incorporate the following safeguards:

- (i) access to arbitration that cannot be impeded by unilateral action or inaction by a government,
- (ii) an impartial and independent arbitral tribunal,
- (iii) meaningful taxpayer participation,
- (iv) an arbitral decision that is binding on the parties and enforceable in domestic courts, and
- (v) a standard of review of arbitral decisions that appropriately balances the need for finality with the need to protect the integrity of the arbitral process.

Our comments are directed to ensuring that these safeguards are in place.

¹ The Securities Industry Association brings together the shared interests of approximately 600 securities firms to accomplish common goals. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. (More information about SIA is available at: www.sia.com.)

I. Access to Arbitration

A. Relationship between arbitration and domestic remedies

1. Proposed Article 25(5) contemplates that in order to initiate arbitration, all persons “directly affected by the case”² must waive their rights to pursue claims in domestic courts or administrative tribunals. While many other types of treaties require a private party to choose between pursuing its rights in arbitration or in domestic courts,³ those treaties typically afford the private party a role in the arbitral process that is comparable to the role of a claimant in domestic courts. Therefore, if this is the model adopted by the OECD, it is desirable that the taxpayer be provided with additional rights with respect to participation in the arbitration process, as described in greater detail below.
2. Proposed Article 25(5) would prohibit access to arbitration “if a decision on the same issues” has already been rendered by a domestic court or administrative tribunal of that State. According to paragraph 54 of the proposed Commentary, this restriction “will apply regardless of whether or not the person who initiated the mutual agreement procedure was a party to the procedure” that resulted in that decision. It is not clear to us why a taxpayer should be deprived of a treaty forum by litigation to which he was not a party. In addition, we seek clarification that the language of Article 25(5) would preclude access to arbitration only if a domestic court or administrative tribunal reached a decision on the treaty claim, and not if the court or tribunal addressed the case only under domestic law.
3. Article 25(5) prevents a case from going to arbitration if a person directly affected by the case is still entitled to pursue domestic remedies. Paragraph 1 of the Sample Agreement permits the taxpayer to satisfy this condition by waiving its rights to domestic remedies. We would ask why the disability on proceeding to arbitration (the existence of a right to domestic remedy) appears in the text of the amendment, but the cure (waiver of such right) appears only in the Sample Agreement. The OECD may wish to consider modifying the amendment to refer to the waiver option.

² Paragraph 54 of the proposed Commentary provides that “a ‘person directly affected by the case,’ includes not only the person who has initiated the mutual agreement procedure but also any other person, such as a related company, the tax liability of which would be directly affected by a *decision* on the relevant issues.” If we are correct in assuming that the word “decision” refers to an “arbitration decision,” we would suggest modifying the text to reflect this clarification. If the word refers to both treaty-based arbitration and domestic decisions, then this definition appears to be broader than necessary. In that case, the definition could instead refer to the person who initiated the mutual agreement procedure, or any related company, the tax liability of which would be directly affected by the case.

³ See, e.g., North American Free Trade Agreement, Art. 1121 (requiring investors, as a condition of submitting a claim to arbitration, to “waive their right to initiate or continue before any administrative tribunal or court under the law of any Party...”)

We also note that Paragraphs 63 and 46 of the proposed Commentary record that some countries have taken the position either that domestic remedies cannot be waived or that there are constitutional or other legal impediments to empowering an arbitral tribunal to decide issues relating to taxation. It would be useful to have an analysis of those legal arguments, as investment treaty practice would suggest that domestic remedies are broadly waivable even in respect of taxation matters. In addition, for jurisdictions in which waiver is not possible, the solution proposed in paragraph 63 would make arbitration effectively unavailable. The Commentary should note that those jurisdictions could consider eliminating the requirement that domestic remedies be foreclosed in order for arbitration to be available.

We also would ask why paragraph 1 of the Sample Agreement requires a taxpayer to waive the right to challenge the arbitration decision in domestic courts when Article 25(5) does not require, as a precondition to arbitration, the unavailability of such a right. In our view, a waiver of the right to challenge the arbitration decision is not necessary. That is because if the CAs agree that the standard of review should be the one specified in paragraph 15 of the Sample Agreement, and they implement that agreement in their domestic law, then that is the standard the domestic court must apply. If the CAs do not agree on a standard in paragraph 15, then each State's domestic law will apply to the review of arbitral decisions and there would be no conflicting standard for the taxpayer to waive.⁴

B. Serious Penalties

Paragraph 47 of the proposed Commentary provides that a country may choose to preclude access to arbitration or not be bound by an arbitral decision for cases in which “serious penalties” have been imposed. We understand that this is related to the consideration that the Joint Working Group is giving to the limited situations in which a country could reasonably decline to take a case to MAP. The question of access to arbitration should be part of that analysis and should not be a separate determination. If a taxpayer is denied access to MAP in one of the situations being considered, then it will follow that he will be denied access to MAP. But if access to MAP is granted, then access to arbitration, if necessary, should follow under the specified procedural rules. There should not be a separate standard or additional hurdle for either access to arbitration or enforcement of the arbitration decision.

C. Failure to Agree to Terms of Reference

- 1.** Paragraph 60 of the proposed Commentary contains a sample form of agreement (“Sample Agreement”) that CAs may use as a basis for implementing the arbitration process. Paragraph 3 of the Sample Agreement contemplates that within 3 months after the request for arbitration has been made, the CAs will agree on the questions to be resolved by the arbitration panel (the “Terms of Reference”), but does not provide for the possibility that the CAs will fail to

⁴ Consistent with the foregoing, we believe the last sentence of paragraph 63 could be deleted.

agree. Such an outcome would result in denying the taxpayer the right to arbitration.

2. A mechanism to address a potential deadlock between the CAs would be to revise the Sample Agreement to provide that:
 - a. the taxpayer's request for arbitration should include the taxpayer's view of the questions that the arbitration panel should address along with factual background and legal analysis sufficient to acquaint the panel with the substance of the dispute;
 - b. (i) the tribunal be constituted within 3 months of the taxpayer filing its request for arbitration (or suitably shorter period if CAs agree to streamlined arbitration), and (ii) the taxpayer's request be given to the tribunal (or arbitrator in the case of streamlined arbitration); and
 - c. if the CAs do not agree to the Terms of Reference within 3 months of the filing of the request for arbitration, then the taxpayer may either withdraw the request for arbitration (and thus revoke any waiver of domestic remedies) or request that the tribunal (or the arbitrator in the case of streamlined arbitration) draft the Terms of Reference, with reference to the taxpayer's request for arbitration and in consultation with CAs and the taxpayer.⁵

II. Impartial and Independent Arbitral Tribunal

A. Independence of Arbitrators

The Sample Agreement and the related proposed Commentary in paragraph 71 do not require the independence of arbitrators appointed by each CA although independence is required for the presiding arbitrator who the CAs appoint by common consent. Paragraph 71 adds that “[o]nce an arbitrator has been appointed, it should be clear that his role is to decide the case on a neutral and objective basis; he is no longer functioning as an advocate for the country that appointed him.” While we understand the benefits of having arbitrators who are familiar with the issues, we also believe it is imperative that the members of the tribunal avoid even the appearance of partiality and lack of independence. Therefore, it would be preferable to exclude current (but not former) government employees from the universe of eligible arbitrators. We recognize that this may entail additional cost; however, the benefit makes it worthwhile.

B. Costs should be borne equally by the Parties

1. Paragraph 12 of the Sample Agreement provides that “each competent authority will bear the remuneration of the arbitrator appointed exclusively by that

⁵ If the final OECD proposal does not permit the tribunal to draft the Terms of Reference where the CAs do not agree, then in any case where the CAs fail to agree and the arbitration does not proceed, any waiver by a taxpayer of its rights to domestic remedies should be deemed null and void.

competent authority....” Thus, the arbitrators appointed by each CA could be compensated at radically different levels. This “pay for your own arbitrator” proposal could create a situation in which the better paid arbitrator might be willing to devote greater time to the case and may appear to have greater incentive to support the position of the CA that appointed him than would the lesser paid arbitrator.

2. This proposed allocation of CA-appointed arbitrator costs differs from that customarily found in other treaty-based state-to-state arbitration regimes where party-appointed arbitrators are typically compensated at the same rate, and all arbitrator costs, whether party-appointed or jointly-appointed, are borne equally by the parties, subject to the tribunals’ discretion to allocate costs otherwise in the decision.⁶

III. Taxpayer Participation

Paragraph 10 of the Sample Agreement recognizes, and SIA strongly agrees, that the taxpayer should be afforded the opportunity to participate, either directly or through its representatives, in the arbitration itself. Paragraph 3 of the Sample Agreement does not, however, permit taxpayer involvement in the drafting of, or taxpayer consent to, the Terms of Reference.

1. Because of the critical importance of the Terms of Reference – defining questions that the tribunal will answer, setting forth procedures, and modifying the Sample Agreement – CAs should, at a minimum, consult with taxpayers and obtain taxpayer consent to the Terms of Reference. If the taxpayer does not consent, the taxpayer should be permitted to choose either (i) to withdraw the request for arbitration (and thus end any waiver of domestic remedies) or (ii) if our suggestion regarding the timing of constituting the tribunal is adopted, to request that the tribunal establish the Terms of Reference in consultation with the CAs and the taxpayer.
2. Paragraph 3 of the Sample Agreement also contemplates that the Terms of Reference may provide “procedural rules that are in addition to, or different from, those included” in the Sample Agreement “and deal with such other matters as are deemed appropriate.” This provision and paragraph 76 of the proposed Commentary should be clarified to ensure that CAs are not allowed to vary those aspects of the Sample Agreement that are related to the basic rights of the taxpayer, such as: (i) the taxpayer’s right to present written submissions and tribunal’s right to request oral testimony from the taxpayer and (ii) the hierarchy of “Applicable Legal Principles,” in particular, that the tribunal shall apply the treaty, interpreted according to the Vienna Convention.

⁶ See, e.g., *EU Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises*, Art. 11(3); 2004 US model bilateral investment treaty, art. 37(3).

IV. Enforcement

- A.** Proposed Article 25(5) provides that “[t]he arbitration decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States.” In addition, paragraph 56 of the proposed Commentary states that “[i]n practice, the decision will be implemented by having the competent authorities solving the case presented under the mutual agreement on the basis of the answers provided by the arbitration decision and, where necessary, adjusting accordingly the taxation of the persons directly affected by the case.” Finally, paragraph 97 of the proposed Commentary adds that “[s]ince the arbitration decision is binding on both Contracting States, failure to implement that decision would result in taxation not in accordance with the Convention and, as such, would allow the person whose taxation is affected to seek relief through domestic legal remedies or by making a new request pursuant to paragraph 1 of the Article.”
- B.** Taxpayer should be entitled to enforce the arbitral decision in domestic courts to ensure that the decision of the tribunal is given full effect. In our view, paragraph 97 does not clearly state this rule; rather, it suggests that the remedy for “failure to implement” is recourse to (i) undefined “domestic legal remedies” (which is similar phraseology to that used in paragraph 63 regarding waiver in order to initiate arbitration) or (ii) to the MAP anew, creating the possibility of an endless loop between the taxpayer and the relevant CA. In interpreting the relevant language of proposed Article 25(5), the Proposed Commentary should make clear that if a CA does not implement the arbitral decision within 6 months (as provided in paragraph 16 of the Sample Agreement), the taxpayer may pursue implementation through an action in the relevant domestic courts.⁷

V. Grounds for Setting Aside an Arbitral Decision

- A.** Paragraph 15 of the Sample Agreement provides that an arbitration decision is final “unless that decision is found to be unenforceable by the courts of one of the Contracting States because of a violation of paragraph 5 of Article 25 or of any procedural rule included in the Terms of Reference or in this agreement that may reasonably have affected the decision.”⁸ While we agree that an arbitration decision should be subject to review in local courts, we think that grounds for setting aside the decision should be limited and clear in order to promote finality.

⁷ The proposed Commentary should make clear that if a taxpayer waives its right to domestic remedies as a condition of submitting a claim to arbitration such waiver does not prevent the taxpayer from enforcing an arbitral decision in domestic court.

⁸ The proposed Commentary should make clear that if a taxpayer waives its right to domestic remedies as a condition of submitting a claim to arbitration such waiver does not prevent the taxpayer from challenging the enforcement of an arbitral decision in domestic court on the grounds set forth in paragraph 15 of the Sample Agreement.

- B.** It is unclear to us what constitutes a “violation” of Article 25(5). We also believe that Paragraph 15 sets too low a standard by permitting a decision to be set aside because “any procedural rule” was violated that “may reasonably have affected the decision.”
- C.** It would be an appropriate balance of interests for the Sample Agreement to provide for a decision to be set aside only in the event that: (i) there was arbitrator bias or corruption, (ii) the tribunal has manifestly exceeded its powers, (iii) there was a serious departure from a fundamental rule of procedure or (iv) subject to the Terms of Reference, the decision failed to state the reasons on which it is based.
- D.** Regardless of the wording of the Sample Agreement, the laws of many countries contain standards of review of arbitral decisions that may differ from the standards of the Sample Agreement – both as drafted and as we have proposed. Each country will have to take its existing law into consideration when drafting this provision in their bilateral agreements. It may be appropriate for the Commentary to note this.

VI. Other Matters

- A.** Paragraph 9 of Sample Agreement provides that “[s]ubject to this agreement and the Terms of Reference, the arbitrators shall adopt those procedural and evidentiary rules that they deem necessary to answer the questions set out in the Terms of Reference.” In our view, it would be desirable to have some consistency among tribunals as to the basic procedures of the arbitration. To that end, we would suggest that paragraph 9 of the Sample Agreement or the proposed Commentary refer to the UNCITRAL Arbitration Rules as the default rules, subject to modification by the tribunal.⁹ The UNCITRAL rules, which are widely used in international arbitrations involving States as parties, address all procedural aspects of an arbitration.
- B.** Paragraph 14 of the Sample Agreement provides that “the [arbitration] decision must be communicated to the competent authorities and the person who made the request for arbitration within six months from the date on which the last of the arbitrators has been appointed.” If the decision is not communicated within that time, the CAs “shall, by mutual consent, either extend that period for a period not exceeding six months or appoint new arbitrators.” In our view, it is unrealistic to expect that arbitrators could review the submissions of the parties, convene a hearing (if they choose to do so), reach agreement among themselves on the decision, and draft a reasoned opinion that reflects that decision, within six months. We would recommend that the Sample Agreement include a longer initial time period. We also note that paragraph 93 of the proposed Commentary states that the CAs “may” agree to extend the deadline or appoint new arbitrators, which should be changed to “shall” if it is to match paragraph 14 of the Sample Agreement.
- C.** Article 25(3) and Double Taxation Cases

⁹ We note that paragraph 74 of the proposed Commentary refers the arbitrators to ICC arbitration rules but recommend that the UNCITRAL rules be considered as they are more frequently employed in arbitrations to which States are parties.

Article 25(3) provides that CAs “may ... consult together for the elimination of double taxation in cases not provided for in the Convention.” The Joint Working Group (“JWG”) has recognized the increasing importance of extending MAP to cases not provided for in a treaty. Indeed, paragraph 41 of the JWG proposal notes that issues arising under Article 25(3) “may well become more important in the future because of the work being done on the attribution of profits to a permanent establishment.”

The JWG identified one area where this issue is particularly important and has drafted amendments to paragraph 37 of the Commentary that provide access to MAP for cases involving double taxation of branches of the same taxpayer.¹⁰ We agree with this proposal and believe it should be expanded. For example, the amendments should provide access to MAP in a case where a third-country resident has a permanent establishment (“PE”) in one Contracting State and the offsetting adjustment is to the income of a resident of a second Contracting State.

In addition, we question whether the permissive, rather than mandatory, nature of Article 25(3) is appropriate given the growing risk of double taxation in connection with the adjustment of the income of PEs. Even where a treaty includes an Article 25(3) provision (and not all treaties do), a country may take the view that taxpayers do not have access to MAP as a matter of right and thus limit access in practice. Countries may also take the position that because Article 25(3) is permissive only the CA lacks the authority to relieve double taxation in such cases.

We believe it is important that treaties make MAP available in cases of double taxation, even if not directly provided for in the treaty. We recommend that access to MAP under Article 25(3), and the right of taxpayers to invoke and receive such access, be endorsed by the JWG.

¹⁰ See Progress Report Proposal 6 for “Future Study”: Scope of paragraph 3 of Article 25 at pp. 33-34.