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Procedures Announced for Mandatory Arbitration under the Germany–United States Tax Treaty

The 2006 protocol to the 1989 tax treaty and protocol between Germany and the United States amended both the treaty and the protocol. The 2006 protocol provides for mandatory arbitration if certain conditions are satisfied. In December 2008, the competent authorities of Germany and the United States signed a Memorandum of Understanding which deals with requests for competent authority assistance and arbitration. It is published in I.R.S. Announcement 2008-124, and guidelines supplementing the Memorandum of Understanding are published in I.R.S. Announcement 2008-125. This article provides an overview of the substantive and procedural provisions for mandatory arbitration in the 2006 protocol and the Memorandum of Understanding.

The authors dedicate this article to their friend and colleague, Joseph H. Guttentag, on the occasion of his 80th birthday in recognition of a lifetime of public service.

1. Introduction

In 2006, Germany and the United States signed a protocol ("2006 protocol") amending the Convention between the Federal Republic of Germany and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital and to certain other Taxes signed on 29 August 1989 ("treaty") and the protocol to the treaty. The protocol, as amended by the 2006 protocol, is hereafter referred to as "amended protocol". The 2006 protocol entered into force on 28 December 2007, and its provisions became effective in 2007 and 2008.[1] One important provision introduced by the 2006 protocol is that double taxation conflicts between the contracting states are subject to mandatory arbitration if certain conditions are satisfied. This change was made by reformulating Art. 25(5) of the treaty and adding new Art. 25(6), which sets forth certain rules and definitions for the arbitration process.

In addition, in order to further define and clarify the new provisions and on the basis of Para. 22(q) of the amended protocol, the United States Internal Revenue Service (I.R.S.) issued Announcement 2008-124, 2008-52 *I.R.B.* 1359, which contains the Memorandum of Understanding between the Competent Authorities of the Federal Republic of Germany and the United States of America ("MOU") that was signed on 8 December 2008. Announcement 2008-124 was accompanied by Announcement 2008-125, 2008-52 *I.R.B.* 1363, which contains the guidelines applicable to arbitration proceedings and the operations of the arbitration board.

This article summarizes the main changes made by the 2006 protocol and the MOU regarding the settlement of tax disputes between the contracting states through arbitration. Given the detailed nature of the 2006 protocol and, in particular, of the MOU regarding arbitration proceedings, this article provides a general overview of the most important provisions.

2. Disputes Eligible for Arbitration

Former Art. 25(5) of the treaty provided (emphasis added):

> Disagreements between the Contracting States regarding the interpretation or application of this Convention shall, as far as possible, be settled by the competent authorities. If a disagreement cannot be resolved by the competent authorities it *may, if both competent authorities agree, be submitted for arbitration*. ...

2.1. 2006 protocol

The 2006 protocol replaced former Art. 25(5) of the treaty with new Art. 25(5), which reads (emphasis added):

> Where, pursuant to a mutual agreement procedure under this Article [Art. 25], the competent authorities have endeavored but are unable to reach a complete agreement in a case, the case *shall*

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1. See Dehnen, Peter, "2006 Amendments to the Germany–United States Tax Treaty Become Effective", *Bulletin for International Taxation* 7 (2008), at 0265.

> *be resolved through arbitration* conducted in the manner prescribed by, and subject to, the requirements of paragraph 6 and any rules or procedures agreed upon by the Contracting States, if ....

While, on its face, new Art. 25(5) seems to require mandatory arbitration, several hurdles must be overcome before arbitration may proceed. Some are contained in the treaty, as amended by the 2006 protocol, and some in the amended protocol. The hurdles may be summarized as follows:

(a) tax returns must have been filed in at least one of the contracting states with respect to the taxable years at issue in the case;

(b) the case must either:
- involve the interpretation of Art. 4 (Residence) (but only regarding the residence of natural persons), Art. 5 (Permanent establishments), Art. 7 (Business profits), Art. 9 (Associated enterprises) or Art. 12 (Royalties) and not be a case which the competent authorities have deemed unsuitable for arbitration;[2] or
- be a particular case which the competent authorities specifically agree is suitable for arbitration; and

(c) all concerned persons, including the affected taxpayer and "all other persons whose tax liability may be directly affected", must agree, before the arbitration proceedings commence, not to disclose "any information received during the course of the arbitration proceeding from either Contracting State or the arbitration board, other than the determination of such board" (Art. 25(5)(c) read together with Art. 25(6)(d) of the treaty).

2.2. Memorandum of Understanding

Para. 2 of the MOU further specifies that:
- an unresolved competent authority request which originated with a bilateral advance pricing agreement (APA) request is eligible for arbitration procedures; and
- neither competent authority may unilaterally cease to consider a case once it has been accepted into the mutual agreement procedure, except in specified circumstances.

In addition to identifying the types of disputes that are generally eligible for arbitration, the MOU specifies the cases that will generally be considered ineligible for arbitration. They are divided into two categories:

(1) Cases that a competent authority has not accepted or in which a competent authority ceases to provide assistance

US provisions

Regarding the United States, reference is made to Sec. 12.02 of Revenue Procedure 2006-54, which lists the cases that the US competent authority will not accept. They include cases where:

(a) the competent authority determines that the taxpayer is not entitled to the treaty benefit or safeguard in question or to the assistance requested;

(b) the taxpayer is willing to accept a competent authority agreement only under conditions that are unreasonable or prejudicial to the interests of the US government;

(c) the taxpayer rejected the competent authority resolution of the same or similar issue in a prior case;

(d) the taxpayer does not agree that competent authority negotiations are a government-to-government activity that does not include the taxpayer's participation in the negotiation proceedings;

(e) the taxpayer does not furnish upon request sufficient information to determine whether the treaty applies to the taxpayer's facts and circumstances;

(f) the taxpayer was found to have acquiesced in a foreign-initiated adjustment that involved significant legal or factual issues which otherwise would be properly handled through the competent authority process and then unilaterally made a corresponding correlative adjustment or claimed an increased foreign tax credit without initially seeking US competent authority assistance;

(g) the taxpayer:
- fails to comply with this Revenue Procedure;
- failed to cooperate with the I.R.S. during the examination of the periods at issue and such failure significantly impedes the ability of the US competent authority to negotiate and conclude an agreement (e.g. significant factual development is required that cannot effectively be completed outside the examination process);
- fails to cooperate with the US competent authority (including failing to provide sufficient facts and documentation to support its claim of double taxation or taxation contrary to the treaty); or
- otherwise significantly impedes the ability of the US competent authority to negotiate and conclude an agreement; or

(h) the transaction giving rise to the request for competent authority assistance:
- is more properly within the jurisdiction of I.R.S. Appeals;
- includes an issue that is pending in a US court or is designated for litigation, unless competent authority consideration is concurred in by the US competent authority and the Associate Chief Counsel (International);
- is a listed tax shelter transaction for purposes of US Treas. Reg. §§ 1.6011-4(b)(2) and 301.6111-2(b)(2); or
- involves fraudulent activity by the taxpayer.

2. Art. XVI(22) of the 2006 protocol, which restates Art. 22 of the 1989 protocol.

German provisions

Regarding Germany, the MOU makes reference to a circular of the Federal Ministry of Finance of 13 July 2006 (IV B 6 S 1300 340/06) which lists the cases the German competent authority will not accept. In this regard, the MOU specifically refers to Secs. 3.2.1, 3.3.1 and 5 of the circular. In contrast to the detailed US provisions, these sections provide only general guidelines.

Sec. 3.2.1, for example, merely states that the taxpayer has the same duty of cooperation in arbitration cases as in domestic tax cases and must fulfil the standard requirements of Sec. 90 of the German Fiscal Code. Sec. 3.3.1 provides that, although the competent authorities of the affected states are the parties to the arbitration, the taxpayer is nevertheless obligated to "contribute to the proceeding through the explanation of its relationships and the designation and provision, where necessary, of supporting documentation".

Sec. 5 provides that the German competent authority will generally not agree to an arbitration proceeding if the affected taxpayer waives its right to commencement of the proceeding. In cases involving related parties or permanent establishments, however, this will apply only if the foreign headquarters waives the commencement or, in the case of related parties, both the domestic and foreign affected parties agree to the waiver.

(2) Cases that have been accepted for competent authority consideration, but the competent authorities agree that the case is not suitable for arbitration

Para. 3 of the MOU points out that these cases will arise particularly where a taxpayer causes "inordinate and/or repeated" delays regarding requests for information or the taxpayer submits the case for litigation and the relevant court does not allow a suspension of proceedings pending a competent authority resolution.

3. Request Submission

3.1. 2006 protocol

Para. 22(p) of the amended protocol, added by the 2006 protocol, specifies that requests for the commencement of a competent authority proceeding must include the information required by the applicable procedural regulations of the contracting states. Regarding the US, reference is made to Revenue Procedure 2002-52 and, regarding Germany, to the Ministry of Finance circular of 1 July 1997 (IV C 5 S 1300 189/96). The last sentence in Para. 22(p) provides that such information will "not be considered received until both competent authorities have received copies of all materials submitted to either Contracting State by the concerned person(s) in connection with the mutual agreement procedure".

3.2. Memorandum of Understanding

Para. 1 of the MOU refers to the following later documents:

- for the US, Revenue Procedure 2006-54, which supersedes Revenue Procedure 2002-52, and Revenue Procedure 2006-9, relating to the APA program of the I.R.S.; and
- for Germany, the Ministry of Finance circular of 13 July 2006 (IV B 6 S 1300 340/06).

Para. 1(b) of the MOU clarifies the last sentence in Para. 22(p) of the amended protocol by providing that the taxpayer need only submit its request for competent authority assistance to the contracting state of which it is a resident. In comparison, if the matter pertains to an income allocation between related parties, both parties must submit requests to the contracting states of which they are residents.

4. Commencement Date

4.1. 2006 protocol

According to Art. 25(6)(b) of the treaty, added by the 2006 protocol, "the 'commencement date' for a case is the earliest date on which the information necessary to undertake substantive consideration for a mutual agreement has been received by both competent authorities". Art. 25(6)(c) provides that arbitration proceedings shall begin on the later of:

- two years after the commencement date of a case, unless both competent authorities have previously agreed to a different date; and
- the earliest date upon which the required nondisclosure agreements are received by both competent authorities.

4.2. Memorandum of Understanding

Para. 4 of the MOU provides that each competent authority must review a request for assistance "[w]ithin 45 days of receipt" of the request and "verify whether it contains the information necessary to undertake substantive consideration for a mutual agreement". If the competent authority determines that the request is not complete, it must inform the taxpayer, within 45 days of receipt of the request, of the additional information that must be provided.

Para. 4(c) of the MOU requires each competent authority to inform the other of the date on which it received sufficient information "to undertake substantive consideration for a mutual agreement"; the latter of these two dates will be the commencement date. The MOU generally reiterates the provisions of the 2006 protocol as to when an arbitration proceeding will begin, but Para. 5(b) of the MOU adds that if the competent authorities agree to begin arbitration proceedings on a date other than that specified by the general rule, they will "confirm that date in writing to each other and to the concerned persons resident in their territory".

5. Nondisclosure Issues

5.1. 2006 Protocol

As mentioned in above (see 2.1.), Art. 25(6)(d) of treaty, which was added by the 2006 protocol, requires the concerned persons and their authorized representatives and agents to agree before the arbitration proceedings begin not to disclose to any other person any information received during the proceedings from either state or the arbitration board, other than the board's determination. It should be noted that "concerned persons" are the taxpayer making the request and all other persons whose tax liability may be affected by the decision of the competent authorities (see Art. 25(6)(a) of the treaty).

Para. 22(n) of the amended protocol adds a nondisclosure obligation on the members of the arbitration board. No information relating to a particular proceeding, including the board's determination, may be disclosed by the members of the arbitration board or their staffs or by either competent authority, except as permitted by the treaty and the domestic laws of the contracting states.

Para. 22(n) further provides that the "material prepared in the course of, or relating to, the Proceeding shall be considered to be information exchanged between the Contracting States" and that the members of the arbitration board and their staffs must agree to "abide by and be subject to the confidentiality and nondisclosure provisions of Article 26 (Exchange of Information and Administrative Assistance)" of the treaty and any applicable domestic laws. Finally, Para. 22(n) specifies that, in the case of a conflict between the confidentiality provisions in the two states, the "most restrictive condition" will apply.

5.2. Memorandum of Understanding

The MOU (Para. 7) does not substantially add to or amend the treaty provisions dealing with the nondisclosure statements required of the concerned parties and their authorized representatives. Para. 14 of the MOU, however, adds further clarification to the confidentiality requirements for the members of the arbitration board by providing that each member must agree to abide by and be subject to the confidentiality and nondisclosure provisions of Art. 26 of the treaty and any applicable domestic laws as well as the Arbitration Board Operation Guidelines that appear in I.R.S. Announcement 2008-125.

6. Arbitration Board

6.1. 2006 protocol

The amended protocol provides the following general rules for the appointment and constitution of the arbitration board:

(1) *Appointment of members of arbitration board.* Under Para. 22(e) of the amended protocol, each contracting state has 60 days after the commencement of an arbitration proceeding to give the other state notice regarding its appointment of a member of the arbitration board. The third member, who will serve as chair of the board, will be appointed jointly by the two state-appointed members within 60 days after the appointment of the second member. If either state fails to appoint a member or if the state-appointed members fail to agree on a third, the member will be appointed within 60 days following the failed appointment by the highest-ranking member of the Secretariat at the OECD Centre for Tax Policy and Administration who is not a citizen of either contracting state. The chair of the board may be chosen from a list of potential candidates provided by the competent authorities, but may not be a citizen of either contracting state.

(2) *Procedural rules.* Para. 22(f) of the amended protocol provides that, as a general rule, the arbitration board may "adopt any procedures necessary for the conduct of its business, provided that the procedures are not inconsistent" with any provision of Art. 25 or the amended protocol.

(3) *Procedural provisions.* According to Para. 22(g) of the amended protocol, the contracting states can provide a "Proposed Resolution" together with a "supporting Position Paper" to the arbitration board within 90 days following the appointment of the chair. After the submission, the proceeding can develop as follows:

(a) if only one contracting state presents a Proposed Resolution within the allotted time, it becomes the determination of the arbitration board;
(b) if both states submit proposals, each state may submit a "Reply Submission" within 180 days of the appointment of the chair and the arbitration board has nine months following appointment of the chair to consider and analyse the proposals, at which time it must announce its determination by accepting one of the Proposed Resolutions;
(c) additional information can be submitted only upon the request of the arbitration board;
(d) during the arbitration proceeding, the competent authorities of the contracting states can nevertheless reach an agreement and thereby end the proceeding. Similarly, a concerned person can rescind its request for arbitration, thereby ending the proceeding; and
(e) the arbitration board must deliver its determination, which will be the adoption of one of the Proposed Resolutions submitted by the contracting states, in writing to them within nine months of the appointment of the chair.

6.2. Memorandum of Understanding

(1) *Appointment of members of the arbitration board.* The MOU does not substantially add to or amend the corresponding provision of the 2006 protocol other than to specify (in Para. 6(d)) that the competent authorities may not appoint as board members current government employees, or former government employees having left government employment within two years of the establishment of the board.

(2) *Procedural rules.* The MOU does not contain specific provisions on the procedural rules to be applied by the arbitration board.

(3) *Procedural provisions.* Para. 9(b) of the MOU provides that "[t]he Proposed Resolution should be drafted in a form that provides a resolution for each specific amount of income, expense or tax at issue in the case", but that it "may also address any related issues identified by a taxpayer's request for competent authority assistance, that are required to be resolved to determine the specific amount of income, expense or tax ...".

According to Paras. 9(a), (d) and (e) of the MOU, the Proposed Resolution may not exceed five pages, the supporting Position Paper may not exceed 30 pages plus annexes, and a Reply Submission may not exceed ten pages, but the "competent authorities may agree on different page limitations" in a particular case.

The MOU also provides, in Para. 10(b), that the board's request for additional information may apply only to existing documents and that the board "may not request new or additional analyses".

7. Applicable Laws

7.1. 2006 protocol

Para. 22(i) of the amended protocol provides that "[i]n making its determination, the arbitration board will apply, as necessary and in descending order of priority":
- the provisions of the treaty;
- any agreed commentaries or explanations of the contracting states concerning the treaty;
- the laws of the contracting states to the extent they are not inconsistent with each other; and
- any OECD Commentary, guidelines or reports regarding relevant analogous portions of the OECD Model Tax Convention.

This provision makes it clear that, to the extent the treaty (including protocol) and the MOU contain conflicting provisions, the provisions of the treaty/protocol will be controlling.

7.2. Memorandum of Understanding

The MOU does not contain any additional rules regarding the laws or regulations to be applied by the arbitration board.

8. Determination of Arbitration Board

8.1. 2006 Protocol

Art. 25(6)(e) of the treaty provides that the determination of the arbitration board will constitute a resolution by mutual agreement and be binding on both contracting states, unless a concerned person does not accept the determination. This general provision is explained by Paras. 22(j) and (k) of the amended protocol, which specify that:
- the determination of the arbitration board is binding on both contracting states, but it does not have any precedential value for future cases;
- each concerned person has 30 days after receiving the board's determination to inform the competent authority whether he will accept the determination. If a concerned person fails to so advise the competent authority within the 30 days, the determination will be deemed to be rejected; and
- if the board's determination is not accepted, the case cannot be the subject of a future arbitration proceeding.

In addition, Para. 22(b) of the amended protocol provides that the arbitration board's determination is limited to determining the amount of income, expense or tax reportable to the contracting states.

8.2. Memorandum of Understanding

Para. 17(c) of the MOU clarifies that the board's determination will also be considered to be rejected by a concerned person if that person fails to advise the competent authority of its acceptance within the 30-day period; the case will then be closed.

9. Correspondence and Documentation

9.1. 2006 Protocol

The last sentence in Para. 22(g) of the amended protocol provides that, except for logistical matters, all communications from the contracting states to the arbitration board will take place exclusively through written communications between the designated competent authorities and the chair of the board.

9.2. Memorandum of Understanding

Para. 15 of the MOU clarifies the provision of the amended protocol regarding communications before the chair is appointed. Para. 15 specifies that the limited form of communication applies after the chair is appointed; before then, the competent authorities may send all correspondence to the two state-appointed board members. Para. 15(d) provides that communications via fax or e-mail are allowed, but that no information that could identify the taxpayer(s) may be included in an e-mail.

10. Advance Pricing Agreements

10.1. 2006 protocol

The only reference in the amended protocol to APAs is in Para. 22(p), which describes the provisions applicable to the submission of a request for review. Regarding the United States, reference is made to Revenue Procedure 2002-52, Sec. 4.05 (and any applicable successor provisions such as Revenue Procedure 2006-54, Sec. 4.05) and, for cases initially submitted as a request for an APA, to the information required to be submitted to the I.R.S. under Revenue Procedure 2006-9, Sec. 4 (or any applicable successor provisions). Regarding Germany, reference is made to the circular of 1 July 1997 (IV C 5 S 1300 189/96) published by the Ministry of Finance (or any applicable successor circular).

10.2. Memorandum of Understanding

In contrast to the general provisions of the amended protocol, Para. 19 of the MOU provides detailed rules for arbitration in the context of APA requests. Para. 19 provides, for example, that a request for a bilateral APA on which the competent authorities were not able to agree is eligible for arbitration, but only if tax returns have been filed for all of the taxable years in question.

Para. 19(b) reiterates that, regarding APA requests, the information that must be submitted is set forth, for the US, in Revenue Procedure 2006-9, Sec. 4. For Germany, reference is made to the information specified in the circular of 5 October 2006 (IV B 4 S 1341 38/06) of the Ministry of Finance.

According to Para. 19(c), the commencement date for an arbitration proceeding regarding a request for an APA is the earlier of:
- the date on which the competent authorities exchanged "position papers setting forth their initial negotiating positions"; or
- two years from the earliest date on which the necessary information was received by both competent authorities.

Arbitration proceedings, however, may not commence before one year following the submission of "the tax return for the later of the corresponding tax years covered by the APA request".

11. Termination

11.1. 2006 protocol

Para. 22(c) of the amended protocol provides that an arbitration proceeding that has been initiated can be terminated by the competent authorities if they "reach a mutual agreement to resolve" the case or if, at any time, a concerned person withdraws "a request for the competent authorities to engage in a Mutual Agreement Procedure".

11.2. Memorandum of Understanding

Para. 18 of the MOU further specifies that if a taxpayer withdraws its request for assistance, the taxpayer "will not ordinarily be allowed access to the competent authority procedures for the same matter and same years". The MOU provides no further guidance as to the circumstances in which such access might be allowed.

12. Arbitration Guidelines

In the United States, the MOU is supplemented by the arbitration guidelines published in Announcement 2008-125 ("the Guidelines"). The Guidelines comprise a simplified set of procedures that will be followed by the United States in arbitration proceedings.

Sec. 1 of the Guidelines deals with the appointment of the chair. The selection process is to begin within five business days after the appointment of the second board member and is to be completed within 60 calendar days thereafter. The competent authorities are to provide a list of agreed persons who may potentially serve as chair. Agreed persons are preferred because of issues regarding governmental contracting. The two board members may, however, select as the chair a person not on the list, provided the competent authorities are informed in writing prior to making the appointment.

Sec. 2 of the Guidelines pertains to nondisclosure and basically follows the provisions of the 2006 protocol (see 5.1.).

Sec. 3 of the Guidelines provides that once the chair accepts the appointment to serve, both competent authorities are to be informed of the acceptance. In addition, the chair's notice to the competent authorities will provide the nondisclosure agreements, the date of appointment and the chair's contact information. In most cases, this will trigger the commencement of the arbitration proceeding.

Sec. 4 of the Guidelines pertains to operating procedures. The arbitration panel may adopt procedures in addition to those set forth in Art. 25 of the treaty or the amended protocol if necessary for the conduct of its business. The additional procedures may not be inconsistent with Art. 25, the amended protocol or any other related agreement between Germany and the United States. The chair is required to provide a written copy of the additional procedures to the competent authorities.

Sec. 5 of the Guidelines, dealing with communication with the competent authorities, provides the procedures applicable before and after the appointment of the chair. Before the chair is appointed, the competent authorities are to send correspondence concurrently to both board members. After the chair is appointed, all correspondence is to be sent to the chair. In addition, all correspondence from the board is to be sent concurrently to the competent authorities.

The board members are not to have ex parte communications with one competent authority except for administrative or logistical matters. Similarly, the board members are not to have communications regarding the issues or matters before the board with the taxpayers involved in the case or their representatives during or after the arbitration proceeding.

All communications, except for logistical matters, between the board and the competent authorities must be in writing. Sec. 5 reiterates the provisions of Para. 15(d) of the MOU (see 9.2.) and provides that express mail or air mail may be used for all correspondence other than that sent via fax or e-mail.

The board members may communicate by telephone, videoconference, fax or face-to-face meetings. They may also communicate by e-mail, but they may not include any taxpayer information in an e-mail. All three board members must be present during substantive discussions.

Secs. 6 and 7 of the Guidelines deal with proposed resolutions, position papers and rebuttal papers and provide

a time frame for submissions that amplifies the MOU. The time frames are those set forth in the Para. 22(g) of the amended protocol (see 6.1. under (c)). Sec. 8 of the Guidelines deals with additional information. Under Para. 22(g) of the amended protocol, the competent authorities may not submit additional information to the board unless requested by the board. A request for additional information from one of the competent authorities must be in writing and must include a response deadline. A copy of the board's request and the competent authority's response must be sent to the other competent authority.

Sec. 9 of the Guidelines deals with board meetings. The board is encouraged to use teleconferencing and videoconferencing rather than face-to-face meetings. If a face-to-face meeting is required, the competent authority of the country that initiated the mutual agreement proceeding (MAP) must arrange facilities for the meeting. The competent authority of the country that proposed an adjustment, denied the credit or the claim for relief is generally considered the competent authority initiating the MAP. If the proceeding involves an APA, the competent authority of the country in which the parent company is located is considered the competent authority initiating the MAP. If the parent company is a resident of a third state, the competent authorities will determine the competent authority serving as the one initiating the MAP.

The competent authority will arrange meeting facilities in a location that minimizes the board's travel time and expenses. Each competent authority may arrange a meeting in the other's meeting facilities, as needed.

Sec. 10 of the Guidelines pertains to a board member's use of staff. Briefly stated, the use of staff is discouraged as the competent authorities anticipate that board members will be able to perform their duties without additional staff. If, however, a board member uses staff, that staff person must sign a nondisclosure agreement before performing any work on the matter and furnish the competent authorities with the agreement. The staff person must be subject to the same conflict of interest rules as the board member. The competent authorities will not compensate the staff member.

Sec. 11 of the Guidelines deals with payment of fees and expenses to the board members in a manner consistent with Para. 22(o) of the amended protocol. Fees and expenses are to be set in accordance with the International Centre for Settlement of Investment Disputes Schedule of Fees for Arbitrators, as in effect on the date on which the arbitration proceedings begin. This covers hotel, meals and incidental costs. With regard to travel expenses, the board members are to be reimbursed for economy class travel. Their compensation will be limited to three days of preparation for two meeting days and for travel days. The professional fee is set at USD 2,000 per day. If additional time is required to properly consider the case, the chair will contact the competent authorities to request approval for the additional time.

Sec. 12 of the Guidelines, pertaining to the inability of a board member to fulfil duties, supplements the MOU in several ways. First, if the chair is unable to fulfil duties, the remaining two board members are to jointly inform both competent authorities and select a new chair within 14 days. If another board member is unable to fulfil duties, the chair is responsible for notifying the competent authorities. The competent authority that selected the board member involved is to select a substitute board member within 14 days. The competent authorities are to consult with the remaining board members to determine a new timetable, if necessary, for consideration of the matter.

Should it come to light that a board member has a conflict of interest that would have prevented his original appointment, he must recuse himself from consideration of the case and inform the competent authorities.

Sec. 13 of the Guidelines deals with the process for the board's determination. Because the arbitration is "baseball" arbitration, the board must adopt, by majority vote, one of the proposed resolutions submitted by the competent authorities. Under Sec. 14, if there is more than one issue, this is done on an issue-by-issue basis. Examples of multiple issue cases are those that involve the transfer of tangible or intangible goods and the performance of services. This supplements Sec. 11 of the MOU.

Sec. 15 of the Guidelines pertains to permanent establishment cases. If the competent authorities have not reached an agreement on the existence of a permanent establishment, the board members must first determine whether a permanent establishment exists. If it is determined that a permanent establishment exists, the board members must determine the amount of profits attributable to it. Accordingly, the competent authorities may submit a position paper and a supporting paper that take alternative positions. For example, a competent authority may take the position that a permanent establishment does not exist and also the position that if the board determines that a permanent establishment exists, a certain amount of income should be allocated to it. This supplements Sec. 12 of the MOU.

Sec. 16 of the Guidelines deals with matters related to the board's determination. Within nine months of the chair's appointment, the chair shall provide the written determination concurrently to each competent authority. Consistent with Para. 22(j) of the amended protocol, it will not include any rationale or analysis. The board is not to determine the treatment of any associated interest or penalties; rather, that treatment will be determined by the applicable domestic law, as provided in Para. 22(m) of the amended protocol.

Consistent with Para. 22(n) of the amended protocol, no information relating to the MAP (including the board's determination) may be disclosed by the board members or their staffs or by either competent authority except as permitted by the treaty and the domestic laws of Germany or the United States.

Under Sec. 17 of the Guidelines, the board's proceedings may be terminated in one of three ways: by the board's determination in the matter, by the competent authorities reaching a mutual agreement, or by a taxpayer's withdrawal of its competent authority request. If a taxpayer withdraws its request, the competent authorities will so notify the board, and the arbitration proceeding is terminated.

At the termination of a proceeding, each board member must immediately destroy all documents and other information received from either competent authority, or otherwise reflecting the board's considerations or discussions, and delete all information that may be stored on a computer, personal data assistant or other electronic devices or media.

13. Summary

Corresponding to the 2008 update of the OECD Model, new Art. 25(5) of the treaty requires mandatory arbitration to settle disputes, and the arbitration board's determination is binding on both contracting states. The extent to which this provision will actually be applied in practice remains unclear. This is due in part to the existence of two somewhat anomalous provisions. First, mandatory arbitration is limited to cases regarding the application of certain enumerated articles of the treaty (see 2.1.). Second, both contracting states must consider the case suitable for arbitration and must agree to its commencement (see Art. 25(5)(b)(bb)) of the treaty). Perhaps the term "mandatory" means "suggested" in this context.

Nonetheless, the introduction of a provision for binding arbitration in a double taxation treaty is a major step towards increased tax certainty, particularly between important trading partners such as the United States and Germany. Unfortunately, many opportunities are afforded to the competent authorities to dilute the binding effect of the provision. Indeed, an arbitration proceeding can be avoided if a contracting state claims that the case is not suitable for arbitration. And, as noted above, the determination of the arbitration board can be rejected by any concerned person.

These weaknesses have not been cured by the Memorandum of Understanding which, in most cases, does little more than reiterate the provisions of Arts. 25(5) and (6) of the treaty and Para. 22 of the amended protocol. The seriousness of the two countries, however, is evidenced by the way the Guidelines address the practical issues in an arbitration proceeding. They deal with the manner the board members are appointed, the time frame for reaching a decision, the procedure for replacing a board member, and termination of the proceedings.

The MOU and the Guidelines bring to mind the saying that even a journey of 10,000 miles starts with a single step. We should remember this when evaluating the efficacy of the provision for mandatory arbitration.

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