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Mandatory Tax Arbitration: The Next Frontier Issue

Jeffrey Owens*

This article looks at the increasing risk of cross border tax disputes as countries begin to implement in different ways the BEPS action plan, examines the existing mechanisms to minimize and resolve such disputes and then focus on the potential of mandatory tax arbitration to provide the certainty that business and governments need in an increasing uncertain political and economic environment.

1 Introductory remarks

Much has been written about the deficiencies of the mutual agreement procedure (MAP) in Article 25 of the OECD and UN Model Conventions, which is foreseen as the primary means to resolve tax treaty disputes.[1] In addition to criticism concerning its functioning,[2] authors commonly mention the onrushing 'tsunami of disputes' following the G20/OECD Base Erosion and Profit Shifting (BEPS) Project, pointing out that the MAP itself and the competent authorities carrying it out are ill-suited to deal with the next onslaught of new cases.[3] And it is indeed an onslaught: since the inception of the OECD's record-keeping of the number of MAP cases fielded by competent authorities of its member countries, the inventory of MAP cases has almost tripled, increasing from 2,352 cases at the end of 2006 to 7,333 cases at the end of 2016.[4] However, a closer look at these very same MAP statistics paints a somewhat different picture, showing that most MAP cases are indeed resolved and result in the removal of double taxation.[5] Nevertheless, even a reasonably well-functioning MAP will not be able to cope with the next onslaught of disputes.

The importance of effective and efficient (i.e. timely) dispute resolution cannot be overstated. Recent research has shown a clear relation between well-functioning dispute resolution mechanisms which increase tax certainty and trade and investment.[6] Moreover, it is not only companies who may be affected. As a result of the BEPS Project, the general public has become increasingly aware of the functioning of the international tax system and its gaps. Confidence in the certainty, fairness and integrity of the international tax system has been severely undermined and this has had a palpable effect on the political climate. The BEPS project aims to restore this confidence and it is not a coincidence that one of its most

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* Director, WU Global Tax Policy Center at the Institute for Austrian and International Tax Law, Vienna University of Economics and Business (WU). Email: Jeffrey.Owens@wu.ac.at. The author would like to thank Laura Turcan and Sriram Govind of WU for their input into this article.

1 R. Ismer, *Article 25 – The Mutual Agreement Procedure*, in *Klaus Vogel on Double Taxation Conventions* 1801, m no. 75, 1810, m no. 104 (E. Reimer & A. Rust eds, 4th ed., Wolter Kluwers 2015); M. Lang, *Introduction to the Law of Double Taxation Conventions* 148, 149 (2d ed., Linde 2013); J. Kollmann & L. Turcan, *Overview of the Existing Mechanisms to Resolve Disputes and Their Challenges*, in *International Arbitration in Tax Matters* 25 (M. Lang & J. Owens eds, IBFD 2015); R. Bicer, *The Effectiveness of Mutual Agreement Procedures as a Means for Settling International Transfer Pricing Disputes*, 21(2) Int'l Transfer Pricing J. 79 (2014).

2 First and foremost of which is the fact that the MAP does not guarantee a solution for the taxation not in accordance with the tax treaty. Even if it does provide such a solution, the MAP arguably lasts too long, at least in a significant subset of cases.

3 *See* among others S. P. Govind & L. Turcan, *The Changing Contours of Dispute Resolution in the International Tax World: Comparing the OECD Multilateral Instrument and the Proposed EU Arbitration Directive*, 71(3/4) Bull. Int'l Tax'n (2017); S. P. Govind & L Turcan, *Cross-Border Tax Dispute Resolution in the 21st Century: A Comparative Study of Existing Bilateral and Multilateral Remedies*, 19(5) Deriv. & Fin. Instruments (2017).

4 *See* OECD, *MAP Statistics* (2016), http://www.oecd.org/tax/dispute/mutual-agreement-procedure-statistics.htm (accessed 30 Apr. 2018). However, it is important to point out that only disputes involving OECD countries were measured till 2015; whereas several members of the Inclusive Framework were included as well in the 2016 version.

5 This can be determined by analysing the detailed statistics provided by each country, which record the number of cases closed with double taxation. This number is fairly small – only 995 cases have either been closed or withdrawn with double taxation between 2006 and 2015. For 2016, the more detailed statistics available as a result of the new statistics reporting framework established by Action 14 show that 59% of cases were resolved by means of an agreement fully eliminating double taxation with another 19% being resolved by means of a unilateral relief while 4% were resolved by means of a domestic remedy. This means that 74% of the MAP cases resolved in 2016 resulted in the removal of double taxation, by different means. It also means that the first stage of the MAP is working properly and filtering out cases that can be solved by the requested competent authority on its own, thus significantly increasing the speediness of resolution.

6 M. Lang & J. Owens, *The Role of Tax Treaties in Facilitating Development and Protecting the Tax Base*, WU International Taxation Research Paper Series, 2014-03 (2014); K. Petkova, A. Stasio & M. Zagler, *On the Relevance of Double Tax Treaties in the Presence of Treaty Shopping*, WU International Taxation Research Paper Series No. 2018-05 (2018).

important action points, Action 14, is titled '*Making Dispute Resolution More Effective*'.

This article discusses the role of mandatory arbitration as a supplement to MAP and how arbitration can play a role in making MAP more effective and efficient. First, it examines several possible designs for an arbitration clause as featured in various instruments (section 2). Second, the advantages and perceived disadvantages of tax treaty arbitration are discussed (section 3). Third, the essential procedural aspects that need to be decided by the Contracting States before entering into arbitration based on the currently available design models are described (section 4) prior to some concluding comments.

2 Concept of tax treaty arbitration: the current approaches

2.1 *The Concept of Tax Treaty Arbitration*

Although MAP has been fairly successful at resolving cross-border tax disputes in several countries, in view of increasing volumes of unresolved cases some OECD States have shown a preference towards supplementing MAP with mandatory arbitration. Arbitration is adopted by the inclusion of an additional paragraph in the MAP article (generally Article 25) of bilateral tax treaties and allows MAP cases that have been unresolved for a certain period of time to mandatorily be submitted to one or more independent persons for a determination or decision that may be, to a certain extent, binding for both States to follow. While this option may be referred to as 'expert determination' or 'arbitration', international tax experts have been referring to this process as 'tax treaty arbitration' owing to familiarity and for ease of reference.[7]

It is important to note that arbitration in tax treaties is entirely different from 'arbitration' in a legal and commercial sense. While commercial arbitration is an alternative dispute resolution mechanism through which disputes can independently be resolved by the parties involved, arbitration is merely a supplementary remedy that may be used only where a case is unresolved through MAP over a prescribed period of time. Further, unlike an arbitration award in commercial arbitration that requires enforcement through a Court system, arbitration results in an 'opinion' that is to be implemented by the competent authorities. In fact, competent authorities may even be given the discretion to arrive at an agreement different from the opinion resulting from the arbitration.[8] Finally, whether initiated by the taxpayer or the competent authorities (depending of the tax treaty provision), arbitration results in a State-State procedure and does not involve the taxpayer, such as in the case of investment arbitration. Therefore, it is clear that arbitration is 'prophylactic' in nature i.e. it aims to ensure that cases are resolved through MAP to avoid having to move into arbitration.[9]

2.2 *The UN Position*

Since 2011, Article 25 of the UN Model Convention dealing with dispute resolution contains two 'alternatives'. Alternative A provides only for MAP. Alternative B, however, provides for MAP supplemented by arbitration, termed 'arbitration' in an additional paragraph 5.

Under this provision, where the competent authorities of two States are unable to reach an agreement to resolve a case through MAP within three years from the presentation of the MAP case to the competent authority of the other State following a MAP request, unresolved issues may be submitted to arbitration at the request of either competent authority and with the knowledge of the taxpayer(s) involved.[10] However, issues that are already subject to the decision of a Court or Tribunal in either State cannot be submitted to arbitration.

Once an opinion is obtained from the arbitral panel, the competent authorities have six months within which they can arrive at a different MAP agreement to resolve the case. Further, the taxpayer(s) or affected parties may also choose to reject this opinion. Once the six month period has elapsed and if the taxpayer(s) does (do) not reject the opinion, it becomes binding on both competent authorities and must be implemented through MAP, irrespective of domestic time limits.

The competent authorities are given discretion as regards the procedure to adopt for arbitration under this provision. The UN Model Commentary on Article 25 gives some additional guidance that States may choose to follow, specifically through a 'sample' mutual agreement that States may use as a template for procedural rules to implement Article 25(5). This 'sample agreement' proposes comprehensive rules as regards the type of arbitration procedure, selection of arbitrators, independence and transparency rules, remuneration of arbitrators, costs, procedural and evidentiary rules, sharing of information

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7 S. P. Govind & S. Rao, *Designing an Inclusive and Equitable Model for International Tax Arbitration: An Indian perspective*, 46(4) Intertax (2018).

8 *See* Alternative B, Art. 25, UN Model Convention (2011); para. 84, Commentary to Art. 25, OECD Model Convention (2017).

9 Para. 64 of the OECD Model Commentary on Art. 25, referred to in the UN Model Commentary on Art. 25; H. J. Ault & J. Sasseville, *2008 OECD Model: The New Arbitration Provision*, 63(5) Bull. Int'l Tax'n (2009); Kollmann & Turcan, *supra* n. 1 referring to the EU Arbitration Convention (1990) possibly creating such an effect.

10 However, para. 17 of the UN Model Commentary on Art. 25 allows States to draft this provision in such a way that the affected taxpayer and not the competent authorities may make this request for arbitration.

and confidentiality rules and implementation/enforcement related rules.[11]

The Commentaries also provide additional guidance on the relationship between the arbitration process and domestic remedies. Given that issues that have already been decided by a Court or Tribunal in either State may not be submitted to arbitration, the taxpayer may have to renounce his right to domestic law remedies on the concerned issue in order to pursue arbitration. Given the exclusivity of the approaches under the Model Convention, it is impractical to allow parallel pursuit of arbitration and domestic remedies. Therefore, upon the beginning of the arbitration procedure, if a taxpayer has made use of domestic remedies and a decision has not yet been reached by the courts or administrative tribunals, the States may ask it to either renounce the remedy or, at the very least, to put the procedure on hold until the arbitration has been completed in order to prevent an abrupt termination of proceedings due to the issuance of the court decision. Taking into account the fact that the pursuit of arbitration requires the investment of significant time, personnel and financial resources on the part of the States and that the MAP implementing the opinion may be overruled by the subsequent use of the domestic remedy, some States may prefer to have the taxpayer renounce the remedies. In States where the competent authorities can deviate from a final Court decision, it is not necessary to force the taxpayer to choose between domestic and treaty remedies. Therefore, such States would generally modify the arbitration clause to exclude the exception for cases already decided at the domestic level.[12]

2.3 *The OECD Model and BEPS Position*

Article 25(5) of the OECD Model Convention was adopted in 2008 and is largely similar to Article 25 (5) in Alternative B of Article 25 of the UN Model Convention. However, there are some significant differences. First, the OECD Model Convention does not contain two alternatives but, the Model generally prescribes the use of arbitration.[13] Second, arbitration is initiated upon the request of a taxpayer and not the competent authorities, as is the case under the UN Model. Third, the OECD Model Convention allows for arbitration when a case is unresolved through MAP for two years, as opposed to the three years prescribed in the UN Model Convention. Fourth, the OECD Model Convention allows for the arbitration request to be made by the affected taxpayer to either competent authority. Finally, the OECD Model Convention does not allow for competent authorities to adopt an agreement different from the arbitration opinion within six months.[14]

While the Draft Report on Action 14 also included some recommendations with respect to arbitration,[15] arbitration was removed from both the minimum standard and the list of best practices in the Final Report on Action 14, earning the OECD heavy criticism from the business community.[16] The reason behind the change was the lack of consensus among key participating countries with respect to arbitration.

For those countries wishing to implement arbitration, a special mandatory binding arbitration clause accompanied by fairly detailed procedural rules was designed from scratch as part of the work on the Multilateral Instrument (MLI) and inserted into its Part VI.[17] Since the inclusion of mandatory arbitration is not compulsory, the application of Part VI is optional. Currently, only twenty-eight, as of March 2018, of the seventy-eight MLI Signatories have opted to apply Part VI.[18] As opposed to the arbitration clauses in the Model Conventions, the clause in Part VI is accompanied by detailed rules on access to arbitration, information requests and timelines, appointment of arbitrators and costs, mode of conduct

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[11] Discussed more in detail in s. 4 of this article.

[12] *See* UN Model Commentary on Art. 25 (2011).

[13] Nevertheless, as a result of the footnote to Art. 25(5), which was only removed as a result of the 2017 update, it was not necessary for countries not wishing to apply the arbitration clause to put forward a reservation on it, which would have been recorded in the OECD Model Commentary. As a result, the positions of OECD member countries, not to mention non-members, concerning the use of arbitration has been made public in the new extended version of the OECD Model (2017). The change in the Model is due to the fact that transparency with respect to the position on arbitration was one of the minimum standards pursuant to BEPS Action 14, *see* OECD, *Making Dispute Resolution Mechanisms More Effective – Action 14: 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 2015).

[14] However, the possibility to do this is highlighted in the Commentaries. *See* para. 84, Commentary to Art. 25 of the OECD Model Convention.

[15] OECD, *Making Dispute Resolution Mechanisms More Effective – Discussion Draft on Action 14*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 2014).

[16] *See* e.g. the comments of Business Industry Advisory Committee (BIAC) at 41 of the OECD, *Comments Received on Public Discussion Draft*, BEPS Action 14: Make Dispute Resolution Mechanisms More Effective (19 Jan. 2015), http://www.oecd.org/ctp/dispute/public-comments-action-14-make-dispute-resolution-mechanisms-more-effective.pdf (accessed 30 Apr. 2018).

[17] A special drafting group was established for this purpose. This is the only aspect in which the MLI goes beyond the scope of what was agreed in a final BEPS report. As a result, the Explanatory Statement on Part VI is also different in substance from that concerning the other MLI provisions, in that it provides guidance on the substance of the rules as well as their application and interrelationship, as opposed to merely referencing the Final Reports of the BEPS Actions with respect to substantive aspects.

[18] Most of these twenty-eight countries correspond to the original twenty countries. Andorra, Curaçao, Fiji, Finland, Greece, Liechtenstein, Malta, Mauritius, New Zealand and Singapore have joined and the US (which did not sign the MLI), Norway (which intends to include arbitration on a bilateral basis) and Poland have not opted for Part VI. *See* Govind & Rao, *supra* n. 7.

of arbitration, independence, transparency and confidentiality.[19] These rules provide a fairly thorough, though not complete, basis for the conduct of the arbitration procedure.

The main characteristic of the MLI arbitration provisions is that they allow for flexibility in approach e.g. with respect to the choice between baseball or independent opinion or other rules, such as open-ended reservations as regards the type of cases that each jurisdiction wants this procedure to apply to. With respect to the design of the arbitration clause, countries can opt to substantively follow either the OECD or the UN Model Convention approach except for the question who initiates a MAP. Several jurisdictions that have not yet fully implemented arbitration in their tax treaties have chosen to apply this provision through the MLI, for instance Fiji, Mauritius and Singapore.

2.4 *The EU Instruments*

While implementing arbitration provisions in tax treaties, countries may also draw inspiration from procedural rules adopted within the European Union for arbitration in tax matters. The EU Arbitration Convention,[20] which was adopted in 1990 and is thus the precursor of tax treaty arbitration clauses, provides for arbitration that is triggered if MAP is unsuccessful for two years, much like under the OECD Model Convention. The EU Convention contains more detailed procedural rules (as in the MLI) for the selection of arbitrators, including a list of independent persons who are suitable to act as arbitrators along with detailed procedural rules for their selection and the selection of the Chair of the arbitral panel. In addition, there are also rules of evidence and the communications with the panel. The Convention also makes the decision of the arbitral panel time bound, which may be a procedural device that countries may draw inspiration from.

A new directive to govern cross-border dispute resolution through instruments such as the Arbitration Convention and tax treaties was approved in late 2017[21] and contains procedural elements that countries may consider while designing supplementary arbitration within their tax treaties such as strict time limits at every stage and access to domestic Courts for the taxpayer in case of inaction at any stage.[22]

3 When is tax treaty arbitration appropriate?

As previously noted, the supplementing of MAP by arbitration alone will not be sufficient to allow competent authorities to deal with the expected tsunami of disputes. However, arbitration plays an essential role in increasing tax certainty and the confidence of the taxpayers in the tax systems, by guaranteeing that the tax treaty obligations committed to by the contracting states will be upheld. Arbitration ensures the fulfilment of the purpose of the tax treaty, which is to prevent any taxation not in accordance with what was agreed between the parties, especially any double taxation, thereby providing a more business friendly tax environment, which in turn will promote investment. The advantages of arbitration to supplement MAP as identified by the UN Model Convention include the prevention of double taxation, an increase in taxpayer certainty, reducing reliance on inefficient, unilateral domestic remedies and above all, the 'prophylactic effect' on MAP.[23]

While MAP has been proven to constitute an effective remedy in the majority of cases involved, there is still a non-negligible number of disputes that cannot be resolved by means of the MAP. Where MAP has been unable to provide effective resolution of all cross-border disputes and/or where there is a feeling that MAP not being time bound has resulted in disputes not being resolved within a reasonable amount of time, arbitration would provide an effective remedy. Arbitration is therefore most appropriate for countries that already have a significant MAP inventory, especially if many of the cases concern the same treaty partner, and where efficiency (i.e. timeliness) of resolution is an essential concern. Arbitration could also prove an interesting option in countries that have large portfolio of cross-border tax cases within their Court system or a judicial system that is not proactive in tax matters. However, the fact that so few countries have signed onto the MLI arbitration provisions suggests that it will take time to achieve widespread adoption of this practice.

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[19] S. P. Govind & L. Turcan, *The Changing Contours of Dispute Resolution in the International Tax World: Comparing the OECD Multilateral Instrument and the Proposed EU Arbitration Directive*, *supra* n. 3.

[20] Convention 90/463/EEC of 23 July 1990 on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises (Arbitration Convention), OJ L 225/10.

[21] Council Directive (EU) 2017/1852 of 10 Oct. 2017 on tax dispute resolution mechanisms in the European Union (Dispute Resolution Directive), OJ L 265/1.

[22] S. P. Govind & L. Turcan, *The Changing Contours of Dispute Resolution in the International Tax World: Comparing the OECD Multilateral Instrument and the Proposed EU Arbitration Directive*, *supra* n. 3; S. P. Govind & L. Turcan, *Cross-Border Tax Dispute Resolution in the 21st Century: A Comparative Study of Existing Bilateral and Multilateral Remedies*, *supra* n. 3.

[23] Para. 5 of the UN Model Commentary on Art. 25 (2011).

Moreover, during the discussions on arbitration in the context of BEPS Action Plan 14 and the MLI, various concerns were raised by developing countries and some emerging and developed economies against the inclusion of arbitration in their tax treaties. These issues echo those identified when the arbitration clause was first introduced into the UN Model Convention and include possible sovereignty and constitutionality concerns, costs and lack of resources, even-handedness in the process, lack of experience and familiarity with MAP and arbitration, transparency and reviewability and enforceability.[24] Although it is questionable whether sovereignty and/or constitutionality would be a legal hurdle to tax treaty arbitration in many countries,[25] it is clear that policy concerns such as even-handedness in arbitration must be overcome for developing countries to have confidence in the process.

4 The devil is in the details: developing a well-functioning arbitration procedure

4.1 *The Importance of Procedural Design*

The importance of the procedural rules for the functioning of arbitration cannot be overstated. As will be shown, at least some of the concerns expressed with respect to arbitration can be addressed or at least mitigated by a careful design of the procedural rules used for arbitration.[26] The following sections highlight the most important aspects of the arbitration procedure and some of the common design choices which should be taken into account by countries considering adopting arbitration.

4.2 *Independent Opinion v. Baseball*

The first and probably the most important procedural question concerns the decision-making process of the arbitral panel. For the longest time the only option in this respect was the so-called 'independent opinion' procedure, but recently the 'baseball arbitration' approach backed by the US and Canada has become increasingly popular, even becoming the default option under the Model Convention s as well as the MLI.

The 'sample' mutual agreement on procedural rules for arbitration introduced in the UN Model Commentaries in 2011 has always endorsed the use of the 'last best offer' or 'baseball' approach to arbitration. Under this approach, both competent authorities are required to propose their most reasonable solution to the case in their submissions to the panel and the arbitral panel is bound to choose one of these solutions to resolve the case. Within two months from the appointment of all arbitrators, each competent authority should present its 'Terms of Reference', which include the unresolved issues to be decided by means of arbitration. The competent authorities must then send in their proposed solutions to the unresolved issues and the panel must choose between one of the proposed resolutions and issue a decision with short reasons within three months from the last reply.[27] The reasons for the UN endorsement of 'baseball arbitration' as opposed to the 'independent opinion' approach, which was proposed by the EU Arbitration Convention and the OECD Model Convention at that time (i.e. the 2010 Model Convention), concern the swiftness and cost effectiveness of this approach.

Unlike the UN Model Convention, the 'sample' mutual agreement in the OECD Model Commentaries till 2014 endorsed the use of the 'independent opinion' approach where the arbitral panel needs to consider the facts of the case, evaluate the evidence presented in the submissions of the competent authorities and review the legal positions involved before arriving at a reasoned decision.[28] However, this has changed post the 2017 update to the OECD Model Convention, following which the sample mutual agreement therein endorses the 'baseball' approach.[29]

Interestingly, the MLI itself allows jurisdictions the option to choose either approach and/or to create customized rules for each dispute.[30] However, the default approach is baseball arbitration, with countries having to opt out of it in order to employ independent opinion arbitration.[31] Moreover, the MLI obviously considers this

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[24] These issues are elaborated in UN Committee of Experts on International Cooperation in Tax Matters, Tenth Session, *Secretariat Paper on Alternative Dispute Resolution in Taxation*, E/C.18/2015/CRP.8 (8 Oct. 2015), http://www.un.org/esa/ffd/wp-content/uploads/2015/10/11STM_CRP8_DisputeResolution.pdf (accessed 30 Apr. 2018); Govind & Rao, *supra* n. 7.

[25] Although several developing and emerging countries have claimed this, academic literature has concluded otherwise in many cases. For instance, *See* Govind & Rao, *supra* n. 7 and L. E. Schoueri, *Arbitration and Constitutional Issues*, in Lang & Owens eds, *supra* n. 1 for a detailed analysis on the constitutional compliance of tax treaty arbitration in India and Brazil respectively.

[26] *See* for instance the proposals made to alleviate the concerns of developing countries in J. Owens, A. Gildemeister & L. Turcan, *Proposal for a New Institutional Framework for Mandatory Dispute Resolution*, 10(82) Tax Notes (2016).

[27] Annex in the UN Model Commentary on Art. 25 (2011).

[28] Annex in the OECD Model Commentary on Art. 25 (2014).

[29] Annex in the OECD Model Commentary on Art. 25 (2017).

[30] *See* Art. 23 of the MLI.

[31] *See* Art. 23 of the MLI.

one of the most important aspects of the procedure and potentially the source of strong controversy as the Parties are allowed to veto the choice made by their treaty partners, resulting in a non-application of the entire Part VI on arbitration until a compromise can be reached with respect to the type of procedure to be implemented.[32]

Countries should carefully weigh the pros and cons of each approach before making a choice, as they have broad-ranging consequences. In general, the 'baseball' approach is expected to be cost efficient, less time consuming and simpler to implement. Moreover, it limits the decision powers of the arbitrators and may thus mitigate concerns with respect to potential biases and criteria for selection. However, countries that would want to provide the taxpayers more legal certainty or that would have to deal with constitutional limitations for taxing decisions to follow the principle of legality as regards consistency of decision-making may choose the 'independent opinion' approach instead.[33]

In practice, countries may wish to keep open their choice of baseball versus independent opinion approach, adopting the approach which seems best suited to specific cases. In this respect, it has been posited that baseball arbitration may be more suitable to deal with large backlogs of cases and especially fact-based cases such as profit allocation cases.[34] In fact, this is how it is employed by the US and Canada, which have restricted the use of arbitration to cases involving the allocation of profits between headquarters and permanent establishments or associated enterprises and cases concerning the existence of permanent establishments.

4.3 *Selection of the Arbitral Panel*

A second very important aspect and one that has been the source of very strong concerns expressed by developing countries is the choice of the persons issuing an opinion on the case. Given the decision powers arbitrators have especially in independent opinion procedures, it is of paramount importance to carefully select the persons on the arbitral panel both with respect to their experience and qualifications and with respect to their independence and freedom from bias.

The sample mutual agreement in the UN Model Commentaries suggests a structure for a three-member arbitral panel. It states that within either three months from notification of the taxpayer of the arbitration or four months from when the other competent authority receives the arbitration request filed with one competent authority, each competent authority shall appoint one arbitrator. Within two months of the last appointment, the two appointed arbitrators shall appoint the third arbitrator, who shall act as the 'Chair'. If no appointment is made as per this process within the prescribed time period, the chair of the UN Committee of Experts on International Cooperation in Tax Matters shall make the appointment within ten days from a request. If such chair is a national of either State involved, the longest serving Committee member who is not a national shall make the appointment.

A similar approach is followed in the sample mutual agreement in the OECD Model Commentaries. However, the power of appointment in case of default is provided instead to the OECD Director of the OECD Centre for Tax Policy and Administration. The MLI provision follows the same format as the OECD Model Convention approach.

Countries may choose from among these approaches or develop a new approach based on their policy goals,[35] including with reference to approaches adopted in the EU Arbitration Convention and Directive such as a panel of larger composition than three members, maintenance of a panel of 'independent' persons[36] and detailed rules regarding selection of the Chair. Developing countries may, however, want to design such rules in a manner which ensures that the constitution of the panel is representative of their tax policy goals as well.

In order to develop experience in arbitration and for capacity building in this regard, countries may adopt an institutional framework and therein, a network of future arbitrators, train tax specialists to be arbitrators (especially in developing countries), include alternative dispute resolution in a domestic context to develop familiarity with processes.[37]

4.4 *Timelines Involved*

As discussed earlier, arbitration was designed to have a 'prophylactic' effect, so as to make MAP more effective. In

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[32] *See* S. P. Govind & L. Turcan, *Cross-Border Tax Dispute Resolution in the 21st Century: A Comparative Study of Existing Bilateral and Multilateral Remedies*, *supra* n. 3.

[33] J. Monhait, *Baseball Arbitration: An ADR Success*, 4(1) Harv. J. Sports & Ent. L. 131–139 (Winter 2013), and B. A. Tulis, *Final Offer 'Baseball' Arbitration: Contexts, Mechanics and Applications*, 20(1) Seton Hall J. Sports & Ent. L. 91 (2010), as cited in R. Petruzzi, P. Koch & L. Turcan, *Baseball Arbitration in Comparison to Other Types of Arbitration*, in Lang & Owens eds, *supra* n. 1, Ch. 6, s. 6.2.2.1, at 142; S. P. Govind & L. Turcan, *The Changing Contours of Dispute Resolution in the International Tax World: Comparing the OECD Multilateral Instrument and the Proposed EU Arbitration Directive*, *supra* n. 3.

[34] *See* for instance Owens, Gildemeister & Turcan, *supra* n. 26.

[35] For instance, the tax treaty between Austria and Germany (2000) has prescribed the European Court of Justice as the arbitrator for supplementary arbitration where MAP is unsuccessful. On 12 Sept. 2017, the Court delivered its first arbitral opinion under this provision in ECJ 12 Sept. 2017, Case C-648/15, ECLI:EU:C:2017:664 (*Republic of Austria v. Federal Republic of Germany*).

[36] Para. 15 of the Annex to the UN Model Commentaries on Art. 25 also suggests the creation of a list of suitable persons for arbitration by the UN Committee of Experts on International Co-operation in Tax Matters.

[37] UN Committee of Experts on International Cooperation in Tax Matters, *supra* n. 24.

this regard, the timelines that trigger possible mandatory arbitration become extremely important. Further, it is important to ensure that arbitration proceedings are concluded in a timely manner as well and thus, to design rules that allow timely conclusion of proceedings.

While the OECD Model Convention as well as the EU options prescribe arbitration after MAP is unsuccessful for two years, the UN Model Convention has extended this timeline to three years. The MLI, however, is flexible and allows for both approaches depending on the choice made by countries.[38] While the OECD and UN Model Convention provisions have automatically triggered arbitration from the date when the case is shared with the other competent authority, the 2017 OECD Model Convention (in line with the MLI), has allowed extension until all information requested for is obtained.[39]

Neither the OECD nor the UN Model Convention prescribes a specific timeline within which the arbitration process should be completed. However, the sample mutual agreements provide for timelines. While the OECD sample mutual agreement provides for six months (under the independent opinion approach), with the 'baseball' approach being proposed under the UN Model Commentaries, this time limit is reduced to three months. However, in the 2017 OECD Model Commentaries, the time limit has been extended to 365 days. Countries may keep this in mind if they are looking at arbitration that supplements MAP to be a 'speedy' solution.

Separately, the EU Dispute Resolution Directive directly provide for legally enforceable timelines within which an opinion is to be delivered by the panel and in the latter case, even make remedies available against inaction in domestic Courts.[40] Countries may also draw reference from these practices if they find it in their interest.

In general, it would be preferable to have speedy solutions in arbitration if possible. Provisions allowing indefinite extension of the MAP prior to arbitration may go against the spirit of the provision. Thus, while looking at procedural rules for tax treaty arbitration, shorter timelines that are enforceable as in the EU Directive may be preferable.

4.5 *Independence and Transparency Rules*

Another matter that is of great importance concerns rules governing the independence and transparency of arbitrators. As discussed above, even-handedness is one of the most important aspects in arbitration and thus, having a neutral arbitrator who is independent of the parties in all respects is crucial.

The sample mutual agreement in the UN Model Commentaries suggests that any person including government officials of either State involved may be an arbitrator unless they were themselves involved in the particular case beforehand. The OECD Model Commentaries provide for the same. However, the UN Model Commentaries also suggest that the arbitrator provide a written statement (or an affidavit) that states his impartiality or neutrality, which is not provided for in the OECD Model Commentaries.

The MLI provides that each arbitrator should be 'impartial' and 'independent' of the tax authorities, the competent authorities and the ministry of finance of each State and of all persons affected by the issue at the time of appointment and that they should maintain status quo throughout the arbitral process and for a reasonable time thereafter.

However, these rules may not be enough, especially for developing countries, since they are looking to ensure that arbitrators bridge the divide in understanding fundamental principles of tax treaties.[41] In terms of a solution, it may be in the interest of countries to require a written 'affidavit' as suggested in the UN Model Commentaries to ensure neutrality and independence.[42]

4.6 *Location of Proceedings*

Countries should generally be free to mutually agree on a place where arbitration proceedings may be conducted. However, countries entering into arbitration clauses with developing countries should note that the location should be chosen that place the least demands on the resources of such countries. Further, countries are free to explore the use of technology such as video conferencing for the conduct of arbitral proceedings which may be a speedy and cost-effective solution.

Further, the sample mutual agreements in both the UN and the OECD Model Commentaries suggest that the competent authority to which the case giving rise to the arbitration was initially presented should be responsible for the logistical arrangements for the meetings of the arbitral panel and will provide the administrative personnel necessary for the conduct of the arbitration process. Countries may consider adopting such a rule in relation to their arbitration clauses as well.

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[38] The MLI may even allow this timeline to be extended indefinitely subject to notification of the taxpayer. *See* Art. 19(1)(b) of the MLI. *See* S. P. Govind & L. Turcan, *The Changing Contours of Dispute Resolution in the International Tax World: Comparing the OECD Multilateral Instrument and the Proposed EU Arbitration Directive*, *supra* n. 3.

[39] Per the MLI, the timeline can also be extended by existing domestic proceedings on the same issue.

[40] Dispute Resolution Directive, *supra* n. 21.

[41] For instance, 'permanent establishment' is interpreted differently by OECD countries and developing and emerging economies such as India. *See* Govind & Rao, *supra* n. 7.

[42] This mechanism is also used in the International Centre for Settlement of Investment Disputes (ICSID) as regards arbitrator independence. *See* S. P. Govind & L. Turcan, *Cross-Border Tax Dispute Resolution in the 21st Century: A Comparative Study of Existing Bilateral and Multilateral Remedies*, *supra* n. 3.

4.7 *Remuneration of Arbitrators and Costs Involved*

Arbitration in general, has oft been criticized as a process that has now become expensive. This is particularly true in the case of commercial and investment arbitration and many countries are reconsidering arbitration in bilateral investment treaties owing to this. Arbitration would necessarily entail some costs in terms of fees for the arbitrators, facilities and additional fees for counsel/representation. Moreover, in terms of a developing country, these fees may be payable in a foreign currency in a scale that is not proportional to the resources available to them. Further, developing countries having limited experience in arbitration may also need to hire outside experts to familiarize their competent authority function with the process, which would increase the costs involved.

Under the UN Model Commentary, in order to reduce costs, the sample mutual agreement suggests paying the arbitrators a bilaterally agreed hourly fee which is restricted to three days of preparation, two meeting days (including videoconferencing) and necessary travel days. Reasonable expenses shall also be reimbursed under this model. The OECD Model Commentaries does not provide suggestions as regards remuneration.

As regards costs, both the OECD and UN Model Commentary, prescribe the following guidelines:

- Each competent authority bears all costs, including travel costs, related to its own participation and in relation to the arbitrator appointed by it or on its behalf by someone else.
- Costs related to the meetings of the panel and the personnel necessary for the process will be borne by the competent authority to which the case giving rise to the arbitration was initially presented.[43]
- All costs in relation to other arbitrators and all other costs will be borne equally by the two States.

Further, the MLI requires a specific mutual agreement between the States on costs and if there is no agreement, each party bearing its own costs with shared costs being split equally.

Some options may be considered by countries for possible reduction of costs including reliance on 'baseball' arbitration, clubbing of cases, taxpayer funding of arbitrations and other material solutions such as division according to prior agreement, division according to arbitrator discretion, the creation of an institutional framework by way of a 'blind fund' or other institutional support for developing countries in funding.[44]

4.8 *Confidentiality*

Since arbitration entails sharing of documents by the parties involved which may include privileged or otherwise sensitive information, confidentiality is an important procedural concern.

The sample mutual agreements in both the UN and the OECD Model Conventions provide that both jurisdictions involved should agree that arbitrators appointed would be deemed to be authorized representatives of the appointing parties as regards communications and the confidentiality of information provided.

The MLI adds another layer of protection by not just prescribing arbitrators as authorized representatives, but three staff members per arbitrator as well and also requires a written statement as regards confidentiality and non-disclosure obligations from each arbitrator and designated staff member.

In sum, the confidentiality rules prescribed within Institutional solutions seem adequate to protect information of taxpayers. However, in terms of security, arbitrators should ensure that data is stored and processed in a secure manner, using technology that is not amenable to breaches, to ensure that confidentiality is maintained.

4.9 *Taxpayer Participation*

Neither the UN Model Convention nor the OECD Model Convention specifically allow for taxpayer participation in the arbitration process. While the sample mutual agreement in the OECD Model Commentaries allows participation by the person requesting the arbitration process in writing to the extent allowed in MAP and orally if allowed by the panel, the UN Model Commentaries do not provide for this since arbitration may only be requested by the competent authorities in the UN Model Convention provision. The MLI, however, does not provide for taxpayer participation. The EU dispute resolution Directive, however, allows for taxpayer participation directly in its wording if agreed to by the arbitral panel.

Since arbitration supplementing MAP may become an adjudicatory process, shifting from the diplomatic remedy that MAP is, it may be appropriate to allow taxpayer participation at the arbitration stage at least to ensure due process and natural justice to taxpayers.[45]

Notes

[43] If presented in both States, the costs will be shared equally.

[44] *See* UN Committee of Experts on International Cooperation in Tax Matters, *supra* n. 24.; Owens, Gildemeister & Turcan, *supra* n. 26; Govind & Rao, *supra* n. 7.

[45] K. Perrou, *Participation of the Taxpayer in MAP and Arbitration: Handicaps and Prospects*, in Lang & Owens eds, *supra* n. 1, at 291; P. Baker & P. Pistone, *General Report: Practical Protection of Taxpayers' Fundamental Rights*, IFA Cahiers (2016), at 65; P. Baker & P. Pistone, *BEPS Action 16: The Taxpayers' Right to an Effective Legal Remedy Under European Law in Cross-Border Situations*, 25(5/6) EC Tax Rev. 341 (2016); S. P. Govind & L. Turcan, *Cross-Border Tax Dispute Resolution in the 21st Century: A Comparative Study of Existing Bilateral and Multilateral Remedies*, *supra* n. 3.

4.10 *Publication of Opinions and Precedential Value*

Arbitration proceedings are generally considered confidential and opinions are not published. However, in order to maintain consistency and to promote confidence in the system, publication of opinions with redacted details should be considered.

The sample mutual agreements in the UN Model Commentaries does not, in default, refer to the possibility of publication of decisions made through arbitration since the UN Model Convention follows the 'baseball' approach. However, it follows the approach adopted in the OECD Model Commentaries if the 'independent opinion' approach is chosen.

The sample mutual agreement in the OECD Model Convention allows publication if agreed to by the person making the request and both competent authorities with redacted details on the understanding that these decisions would carry no precedential value. A similar approach for redacted publication is allowed under the EU Dispute Resolution Directive but without the requirement for permission of the parties involved. The MLI does not allow the publication of decisions even in the 'independent opinion' approach.

As cited in the UN and OECD Model Commentaries, publication of decisions in the 'independent opinion' approach may add additional transparency and although there may be no precedential value, may serve as a guideline to avoid further disputes of a similar nature. Countries may take this into account while designing their arbitration clauses.

4.11 *Implementation and Enforcement of Opinion*

As discussed above, unlike in commercial arbitration, tax treaty arbitration merely supplements MAP, leading to an opinion that is to be implemented through MAP. Since such implementation is up to the tax authorities of each State, reviewability and enforceability has been questioned.

Both the UN and OECD Model Conventions provide that the arbitral opinion shall be final and binding on the competent authorities to implement through a MAP agreement, unless the taxpayer rejects the opinion. However, the UN Model Convention adds another layer of protection as described above and allows the competent authorities an opportunity to arrive at an agreement that is different to the opinion within six months before the opinion is made final.

As discussed above, countries that may have concerns of sovereignty in relation to providing binding decision-making authority to a third party may adopt the UN Model Convention approach so as to provide the competent authorities the power to reject the arbitration opinion through a separate agreement within six months after the opinion is delivered.

As regards implementation, within the existing Model Conventions, it is questionable as to whether a taxpayer may enforce an arbitration opinion and compel competent authorities to adopt the outcomes. Domestic law provisions as regards enforcement of MAP agreements should apply in this regard.[46]

In mandatory binding arbitration in tax treaties, opinions are considered binding on the competent authorities. In some States, inherent powers granted to Courts under constitutional law may allow review of such opinions, either before or after they are implemented through mutual agreement. However, in order to facilitate States that do not grant such powers to Courts, a mechanism may be developed as under the ICC rules or the ICSID Convention facilitating review in certain situations or a full appeal process may be developed as in the case of the World Trade Organization agreements. Similarly, a specific mechanism for enforcement may be created as in the case of commercial disputes[47] or investment treaty disputes.[48]

5 Concluding comments

Structural changes in the world of international taxation are always slow and sometimes painful. The move towards mandatory arbitration will be no exception. But there are signs that the international community now accepts that in today's economic environment, more needs to be done to provide greater tax certainty to both business and government and that some form of arbitration may be one way to achieve this. Both the UN and OECD Model Conventions now have text on arbitration that countries can use; the MLI provides an approach for a quick implementation of such provisions; the FTA MAP Forum is likely in the longer term to gently push more countries towards arbitration; and the recently created Subcommittee of the UN Tax Committee on Disputes will provide a Forum where developing countries can gain experience and confidence in arbitration.

Notes

[46] Govind & Rao, *supra* n. 7.

[47] UNICITRAL, Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958).

[48] ICSID, The Convention on the Settlement of Investment Disputes between States and Nationals of Other States (2006).

What is important is that as countries – developed, emerging and developing – move down this path we need to address the perceived political, technical and institutional concerns that are currently discouraging countries from inserting such clauses into their tax treaties. This will take time. The debate will undoubtedly be lively. Moving forward will require breaking some of the traditional taboos that surround MAP: the reluctance to have more transparency in the process; the fear of setting precedents; the unwillingness to give the taxpayer an inside seat; the perceived dangers of institutionalizing the process. It will also require a new commitment to build up the capacity of countries to deal with disputes and to broaden the range and experiences of people that sit on MAP and arbitration panels. As we go through this debate the tax community has much to learn from the way that cross border disputes are resolved in non-tax agreements:[49] both negative and positive lessons. The arbitration mechanisms found in these agreements are proving just as controversial as tax arbitration but the trade and investment community seems more open to consider major structural changes than the tax community.

More generally, this debate is too important to be left to tax experts. Our world today is characterized by both political and economic uncertainties as power moves from the West to the East. Business Models are rapidly evolving. New technologies are challenging our traditional tax concepts and changing the way that tax administrations and taxpayers interact. All of these changes are creating unprecedented levels of uncertainty which means that the tax community must do everything it can to reduce tax uncertainty, which in turn will require political leadership from the top. Finance Ministers know this, which is why they have supported the work of G20 to reduce tax uncertainty. I suspect that when we look back on this debate in ten years' time, we will ask ourselves why did it take so long to get to the point where arbitration becomes the norm not the exception.

Notes

[49] *See* J. Owens, R. McDonell, R. Franzsen & J. Amos, *Inter-Agency Cooperation and Good Tax Governance in Africa* (Pretoria University Law Press 2017).