Arbitration in International Tax Matters

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Dispute resolution under international tax treaties is becoming increasingly relevant. Over time the OECD has developed administrative mechanisms to tackle this problem, by introducing a mutual agreement procedure (MAP) into article 25 of the OECD model convention. Nevertheless, taxpayers called for stronger procedures and, thus, a provision on tax treaty arbitration was introduced in 2008. The OECD’s most recent initiative regarding article 25 is action 14 of the base erosion and profit-shifting action plan, which aims to increase the effectiveness of the MAP and move toward mandatory arbitration.

The report on BEPS action 14, which was published in December, provided an opportunity to reevaluate both the MAP and arbitration as tools for dispute resolution. On January 19 and 20, a workshop on the topic was held in Vienna at the Vienna University of Economics and Business (WU) by the Global Tax Policy Center headed by Jeffrey Owens of the Institute for Austrian and International Tax Law. The workshop was only the first step of a planned three-year project on the use of arbitration in tax matters. The aim of the project is to produce high-quality and cutting-edge research that will move forward the discussions on mandatory arbitration, addressing many of the conceptual and practical concerns that non-OECD countries have raised. The workshop brought together leading private sector experts in the field, as well as policymakers from bodies such as the OECD, U.N., World Bank, and the European Commission as well as practitioners. This article summarizes the main issues discussed during the workshop.

MAP and Arbitration

The conference began with a short overview provided by Jeffrey Owens (WU) and Michael Lang (WU). The other keynote speakers of the first session were Patricia Brown (University of Miami School of Law) and Jean-Pierre Lieb (EY France).

A brief history of the arbitration clauses in tax treaties as well as article 25(5) of the OECD model was

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1See the 2014 OECD model convention.

presented by Lang. Since its introduction into the OECD model, the MAP has become increasingly popular as a means to resolve disputes, as indicated by the almost twofold increase in the cases reported by OECD members between 2008 and 2012. The arbitration clause, however, has not seen a similar increase in popularity. Only a small number of OECD countries are actively promoting arbitration. Owens later discussed the current state of play, stressing the “tsunami of disputes” that can be expected as a result of the increasing complexity of tax rules, the rise of the BRICS (Brazil, Russia, India, China, South Africa) countries as new players on the international stage, the aggressive use of tax incentives by some countries (such as the United Kingdom), and the BEPS project itself.

Brown then summarized her conclusions regarding current trends in the MAP, which she based on an in-depth analysis of the OECD MAP statistics. She challenged the common perception of the MAP as a fundamentally broken process, arguing that the increasing use of this tool by taxpayers and the relatively constant average resolution time (two years) show that the MAP can (and in most cases does) work well. Nevertheless, the number of cases in which it does not work is still too high. Brown also pointed out that the nature of the relationship between the two competent authorities can have significant effects on the outcome of cases and the speediness of their resolution. She advocated for arbitration as a means of enhancing the MAP, rather than replacing it.

Lieb presented the results of an EY survey of the competent authorities in eight countries (Brazil, China, France, Italy, Japan, Mexico, South Africa, and Turkey) on their insights concerning arbitration. Of the countries surveyed, only France, Italy, Mexico, South Africa, and Japan had concluded a treaty with an arbitration clause, and only France and Italy had already applied an arbitration provision. The arbitration clauses negotiated in practice were, however, fairly similar to article 25(5) of the OECD model. The MAP statistics suggest that tax administrations may be at capacity, since the 14 percent increase in the inventory of new cases compared with 2012 was coupled with a 30 percent reduction in the number of cases resolved. Lieb said he believes that more countries should at least consider introducing arbitration clauses as a way to encourage resolution of MAP cases.

The subsequent discussion centered on the underlying reasons for the deviations of MAP statistics between countries, such as different approaches of the competent authorities and the budgetary constraints, as well as the question of which type of arbitration would be most suitable. Brown, Daniel Gutmann (University of Paris I), and David Rosenbloom (Caplin & Drysdale Chtd.) expressed support for baseball arbitration, while Michael Lennard (International Tax Cooperation, U.N.) voiced concerns that this would put developing countries at a disadvantage.

Constitutional Issues

The second session launched an in-depth discussion of the most suitable type of arbitration as well as the shortcomings of this means of dispute resolution. Rosenbloom, Louis Eduardo Schoueri (University of São Paulo), and Stig Sollund (Ministry of Finance, Norway) led this debate.

Rosenbloom presented the U.S. perspective on arbitration based on the Canada-U.S. tax treaty, under which several cases have already been resolved. While the Canada-U.S. experience is unique because of the historic, geographic, and economic relationship of the two countries, as well as the specific treaty provisions pertaining to arbitration, it is decidedly positive and may thus help countries overcome their initial reservations. Moreover, the United States had many of the same concerns now voiced by other countries, such as the issue of fiscal sovereignty, the confidentiality requirement, and the potential bias of arbitrators. These concerns seem to have been placated by the introduction of the baseball arbitration provisions.

The subsequent discussion concerned the question whether baseball arbitration was indeed the formula for success. Several aspects were criticized, especially the position of the taxpayer, the lack of written opinions and reasons for the award, and the position of developing countries, which is characterized by a gap in understanding and resources and mistrust toward the arbitrators because of their potential bias toward developed countries. Some commentators voiced the concern that arbitration constituted a deviation from the principle of the “natural judge” chosen by law and should thus be limited to purely factual issues, while others countered that deciding to renounce sovereignty in favor of arbitration constitutes an exercise of sovereignty itself.

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6While it has been adopted into a number of treaties, this number remains comparatively small. As of March 2014, 178 bilateral income tax treaties included some form of an arbitration clause; see Pit, “Arbitration under the OECD Model Convention: Follow-up under Double Tax Conventions: An Evaluation,” Inter Tax (2014), 445.

7These states include the Netherlands (38); Canada (20); Switzerland (17); Italy and the United Kingdom (16); Mexico and the United States (12); and to a lesser extent Austria, Germany, and Hong Kong (nine), Luxembourg (eight), and Belgium, Japan, and Kazakhstan (seven); see Pit, supra note 4, at 448.

8The arbitration provisions were introduced in the 2009 protocol to the treaty and include detailed procedural rules.
Thus, tax treaties are not different from other international agreements, which also limit sovereignty. Many believed that the constitution issue is merely being used by tax administrations as an excuse to prevent losing control.

Schoueri acknowledged that several Latin American countries, including Brazil, have reservations against both the MAP and arbitration, alleging that they infringe the principle of legality. He argued that these concerns are unfounded and that there are no relevant constitutional obstacles to the adoption of arbitration clauses in tax treaties. The principle of legality is not affected, since the limits of tax jurisdiction are set forth in the tax treaty and the aim of the MAP and, by extension, arbitration is merely to interpret this treaty. Arbitration does not deprive the taxpayer of the natural judge, since, under article 25(5), he is the one requesting the procedure.

Sollund outlined the position of Norway on the issue of constitutionality. This issue was first discussed during the debate on whether Norway should join the EU Arbitration Convention in the 1990s. The reservations were dropped then and as a result, a renewed discussion was not necessary following the introduction of article 25(5) of the OECD model.

The EU’s Role

The third session dealt with the question of whether the EU Arbitration Convention is a successful tool to resolve disputes. The panel members were Claus Staringer (WU), Juan López Rodriguez (European Commission), and Hugh Ault (Boston College Law School). Staringer explained the function of the EU Arbitration Convention. It is a multilateral treaty signed by the EU member states, has been in force since 1995, and applies in all EU member states except Croatia. It is applicable for resolving disputes in cases of double taxation occurring as a consequence of transfer pricing adjustments in one or more EU member states. Under the EU Arbitration Convention, elimination of double taxation should be granted in two phases. The first phase is the mutual agreement phase: Within a two-year period, the competent authorities investigate the case and work on an agreement. If they fail to reach an agreement, the second phase starts and it comes to compulsory arbitration proceedings. Within six months, an advisory commission must be set up by the member states. This commission must decide within another six months. The decision is nonbinding, because the member states are free to agree on an equivalent solution that eliminates double taxation. Nevertheless, if they fail to reach an agreement, they are obliged to implement the decision made by the commission.

By the end of 2012, there were 848 pending cases but only a handful were finalized through an arbitration decision. These statistics were heavily discussed at the meeting and some suggested that the EU Arbitration Convention is so unattractive that taxpayers do not rely on it. Others argued that it encourages the member states to make use of the MAP more effectively and that most of the disputes are resolved even before reaching the second phase.

Rodriguez presented the findings of the communication from the commission to the European Parliament, the European Council, and the European Economic and Social Committee. It showed that the European tax systems do not contribute to simplify the present legal framework and that double taxation is a major impediment and challenge for the internal market. Only 6 percent of the corporate taxpayers that participated in the public consultation indicated that they had never encountered a dispute concerning double taxation in cross-border situations. He pointed out various reasons for double taxation and showed that the most typical remedy is the MAP, being used by 60 percent of the taxpayers who participated in the survey. However, 40 percent of the MAP cases initiated three years before had not finished with an agreed solution. He then presented possible solutions in order to ensure a more effective dispute resolution process, with the most likely solution being an EU directive providing for an arbitration procedure to solve conflicting cases deriving from the interpretation and application of income tax treaties. This directive could complement or eventually replace the EU Arbitration Convention aiming at extending its procedure to juridical double taxation arising on any type of income. It would also establish a MAP between competent authorities from the member states.

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9 Norway eventually ratified the convention.
10 Norway has two tax treaties with an arbitration clause.
12 An additional conference paper was written by Bertil Wieman (Uppsala University).
13 See article 6 of the EU Arbitration Convention.
14 See article 7 of the EU Arbitration Convention.
15 See article 12 of the EU Arbitration Convention.
Ault explained that he examined different existing institutional arbitration procedures in non-treaty arbitration. He pointed out that MAP stands for an alternative dispute resolution mechanism to domestic litigation. It is a government-to-government procedure. This feature distinguishes it from existing institutional arbitration procedures, which are mainly targeted at private parties. Implementing arbitration under income tax treaties has long been discussed. In 2008 it was introduced as a supplementary tool because it is considered rather difficult to draft arbitration as a separate and alternative measure to the MAP and domestic litigation.

**Qualification of Arbitrators**

The fourth panel focused on procedural aspects of arbitration proceedings. The following three topics were discussed: qualification of arbitrators, procedural rules, and the role of taxpayers.

Ricardo Escobar (Universidad de Chile) introduced the topic of qualification of arbitrators and put the main emphasis on the conditions that are required for an unbiased and coherent arbitration decision. He suggested that in order to meet these goals, the award should be rendered by tax specialists experienced in common law and civil law. However, specialists who are not familiar with tax law could be appointed upon certain conditions since they are perceived as trustworthy. Appointed arbitrators should be independent, which means they cannot be citizens or residents of a state involved in the dispute. Moreover, they should not have any commercial affiliations with the case. A further measure to increase independence could be a list containing the number of cases arbitrated by a particular arbitrator. This could help avoid the possibility that arbitrators only decide cases for the same state and thus try to find future clients. Therefore, limitations of a maximum case number within a specific period should be introduced. Last, the conditions for a coherent decision-making process were elaborated. The decisive role was ascribed to transparency and therefore arbitral decisions should be published. Most cases are decided based on similar rules and could serve as precedents. A change in jurisprudence then requires a thorough justification of the reasons.

The issue of transparency was discussed next. It was emphasized that transparency improves predictability. Parties to the dispute would like to know the reasons for the award. Some arguments against publishing the award were also raised. It was pointed out that the MAP is a confidential procedure. If arbitration is only supplementary to it, it should not be transparent.

Daniel Gutmann put the main emphasis on the specificity of international tax arbitration as an extension of the MAP. In international tax treaty law, the arbitral panel has limited authority compared with a typical arbitral tribunal in, for example, investment arbitration. States may remain in control of the procedure, because under article 25(5) of the OECD model, convention arbitration only takes place after the MAP fails. Therefore, some improvements were suggested. First, a wider use of other alternative dispute settlement methods as mediation or conciliation could be beneficial. For the sake of correctness of the arbitral decision, the arbitral panel should be given more power. It could be empowered to carry out its own investigation.

The concluding topic discussed during this panel considered the role of the taxpayer in the MAP and arbitration. The introduction was given by Katerina Perrou (University of Athens Law School), who supported the view that taxpayers should be granted fair trial guarantees to protect their rights. Even though the MAP stems from the diplomatic procedure in which confidentiality is of great importance, fair trial requirements must be met. Moreover, the MAP should not be treated as an alternative solution to domestic dispute resolution proceedings, but should be preferred in bilateral cases of double taxation. Taking this into account, individual access to the international system of tax dispute should be required.

In the following discussion, it was asserted that the direct access of a taxpayer to the MAP would mean a fundamental reconstruction of the MAP and it could discourage countries from using both the MAP and arbitration.

**BEPS Action 14**

In this session, Marlies de Ruiter (OECD) explained the aim of the OECD BEPS action 14 discussion draft. In her statement, she emphasized the intention that lies behind the deliverable on this action. The MAP is perceived as a good solution to tax treaty disputes, but some problems were recognized in its implementation. Therefore, it is necessary to improve it. In order to attain this goal, political commitment, new meaningful standards, and monitoring of the procedure are required. The MAP may serve as a good basis for an effective and efficient tool to resolve disputes. However, it might need more transparency and participation of taxpayers. The special role must be ascribed to reviewing process. Countries could share their experience in the MAP. This could result in encouraging developing countries to participate in the mechanism.

After this presentation a general discussion on BEPS action 14 followed. It was pointed out that it does not put forward any substantial changes to the existing dispute resolution mechanism. Furthermore, it was suggested that the multilateral instrument as proposed under BEPS action 15 could serve as the framework for arbitration as a separate and new dispute settlement procedure in international tax law.

Finality of Arbitration Decisions

In the sixth panel of the workshop, attention was paid to the arbitration decision. The issue was examined from three perspectives: finality, implementation, and publication of the decision.

The issue of finality of arbitration decisions was presented by Alexander Rust (WU), who examined situations when the arbitral decision might not be enforceable. In reference to the OECD commentary, the award might not be enforceable because of a violation of article 25(5) or of any procedural rule stipulated in the terms of reference or in the rules of the MAP.19 Rust referred to the International Centre for Settlement of Investment Disputes (ICSID) procedure of annulment.20 This procedure provides parties of a dispute with the right to annul the award upon limited grounds — for example, that the tribunal was not properly constituted. Article 25(5) of the OECD model could be supplemented with a similar procedure in order to provide an a priori possibility to challenge awards upon grounds clearly set forth.

Next, the implementation of arbitration decisions in domestic systems was analyzed by Scott Wilkie (Blake, Cassels & Graydon LLP, Canada). He highlighted that if the treaty provides a MAP, it should be given legal effect. It means awards rendered by arbitral panels within the MAP should be incorporated in domestic tax assessment process and outcome. Even if there are legal impediments that could limit their effective implementation, they should be overcome by taking into account overarching tax treaty obligations. Separate means to challenge arbitration decisions are not expected, since they stand for a part of the MAP decision. Only the MAP decision may be open to challenge.

Finally, John Avery Jones (London School of Economics) highlighted the importance of publishing arbitration decisions. He said the publication of decisions is necessary in order to present the reasoning behind them. This should apply to decisions in which tax treaties or the OECD transfer pricing guidelines are interpreted, and even for decisions made under baseball arbitration, redacted information could be made public. Moreover, the names of the arbitrators and experts should be made public. This will increase trust in arbitration. Exceptions from this general rule can be provided for commercial secrets or for other cases upon request of the taxpayer.

This topic triggered a discussion on transparency versus confidentiality in the MAP. The issue was raised that the confidentiality of the MAP is outdated in today’s world. Governments’ demands for taxpayer transparency are inconsistent with the secret proceedings under the MAP. It is difficult to explain why, for example, the legislative procedures or domestic court judgments are generally made public, whereas the MAP still remains confidential. A more transparent procedure could bring clarifications to the interpretation of tax treaties as well as reveal objectives that are behind the tax treaties.

Comparison of Arbitration Provisions

This session compared the arbitration provisions included in bilateral investment treaties (BITs), free trade agreements, and tax treaties. Julien Chaisse (professor of international economic law at the Chinese University of Hong Kong), Hafiz Choudhury (ITIC), and Cym Lowell (ICC and McDermott Will & Emery) gave an introduction to this topic.

The presentation dealt with the advantages and disadvantages or problems of the already existing arbitration procedures in different treaties and asked what policy makers can learn from the existing arbitration procedures.

Chaisse stated that BITs have been a success as shown by the increasing number of treaties and disputes going to arbitration. Arbitration procedures under BITs were promoted as being fast and inexpensive, but the practice has proved to be different. In reality, it is a long process that can be quite expensive. BITs are rather complex compared to tax treaties and can vary significantly in context since there is no standard model to follow. He noted that a number of investment disputes have already dealt with tax matters, and it could be argued that there is a de facto arbitration of taxes through BITs.

The WTO provides for dispute settlement mechanisms. These mechanisms are simple, timely, and have a strong institutional structure. Furthermore, the remedies are binding, quick, and enforceable. These features should be adapted when drafting arbitration provisions for tax treaties.

Since countries are already using these various arbitration procedures in different treaties, this experience — both positive and negative — could be used for tax treaty arbitration.

The discussion that followed mainly focused on BITs and whether their arbitration procedures could be implemented into tax treaties. Some commented that BITs are not generally seen as successful and are expensive and biased toward investors — a perception widespread among developing countries. These countries will need to be convinced of arbitration as a way of providing greater certainty to inward investors. But there was widespread agreement that before considering tax arbitration, they will have to address the question of how the incapacities for arbitration may be built in those countries.

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19 See para. 18 of the OECD Sample Mutual Agreement on Arbitration.
20 The annulment mechanism is set forth in article 50 of the arbitration rules of the ICSID as read in conjunction with article 52 of the convention on the Settlement of Investment Disputes between States and Nationals of Other States.
The Approach of Developing Countries

The keynote speakers of the seventh session dealing with international tax arbitration and developing countries were Lennard and Schoueri.

Lennard explained the main problems arising in this field for developing countries: high costs of arbitral proceedings in comparison to the MAP — for example, ICSID investment arbitration cases had an average cost of $8 million per party, with 82 percent being lawyers' fees. In comparison to domestic litigation or the MAP, these high costs are a result of the costs of judges, courtrooms, administrative fees, translation, travel expenses, and so forth. As a possible solution, it was suggested that costs be split according to the ability-to-pay principle or that more inexpensive simplified procedures be introduced.

A further issue already raised in previous sessions was transparency of the proceedings and neutrality and qualification of the arbitrators. From the point of view of developing countries, arbitrators should have an understanding of the economic and social situation and the developing countries' background. For example, delays in interactions of competent authorities could result from lacking resources rather than from the unwillingness to cooperate. Furthermore, the relationship between the arbitrator and the developed countries could be regarded as non-neutral, because the arbitrator could see the developed country as a future client and try to issue a decision in favor of the developed country. The fact that arbitral decisions are not published heighten this concern.

The subsequent discussion showed that approximately two-thirds of countries are unable to follow the guidelines set by the OECD. Even among OECD members, there is no consensus on including an arbitration provision. Thus, it is important to look for short- and long-term solutions regarding developing countries, because building confidence for arbitration will take some time. Also, more attention should be given to the U.N. model and mediation and consolation methods could play a more significant role. Some participants questioned the high cost, noting that many difficult national cases have triggered tax remedies often amounting to billions of dollars and compared with that, costs of arbitration are relatively low.

Establishing a New Framework

The last session of the conference dealt with the establishment of a new international framework regarding tax arbitration. The presentations were given by Philip Baker (Queen's Counsel — Field Court Tax Chambers, London; Institute of Advanced Legal Studies, London University), Owens, and Lang.

Baker focused on human rights law and its impact on the existing system for resolving international tax disputes. The existing MAP mechanism without a provision on arbitration does not fulfill any of the fair trial requirements under human rights law. Although it could be argued that the MAP is an optional procedure and the taxpayer always has the ability to use domestic litigation procedures, which should guarantee fair trial standards, there are many kinds of disputes that can be solved only through the MAP. Therefore, including arbitration in the MAP is a way to meet at least some of the fair trial requirements. He noted that experienced tax experts are needed to resolve international tax disputes. Since the international tax cases are complex, especially in transfer pricing cases, only highly qualified experts are in a position to find an answer for the underlying dispute. The last part of his presentation elaborated on how a multilateral instrument could be used to introduce an arbitration clause in existing and new income tax treaties.

Much of the discussion focused on whether the MAP violates the fair trial standards. Some participants argued that the MAP as an option did not violate fair trial standards, because it was only an addition to domestic litigation procedures, which fulfill fair trial requirements. There are only a small number of cases in which the MAP is the sole effective remedy. Others believed that a MAP must also fulfill fair trial requirements, even though it is an optional procedure.

Lang also shared his views regarding arbitration with participants. He suggested linking the limitation on benefits clause or the principle purpose test (PPT) clause with arbitration. This means that LOB or PPT clauses should only be implemented in tax treaties if there is also an arbitration clause. In this way, arbitration could counterbalance the restrictive policy introduced by states to tax treaties. Another proposal is to design a multilateral convention only for arbitration. The EU Arbitration Convention could serve as a basis for this new instrument. Furthermore, Lang suggested that the creation of a list of arbitrators under auspices of the U.N. and OECD could be a starting point to promote and facilitate arbitration.

Owens presented a proposal for a self-standing arbitration panel under the auspices of the U.N. and OECD. A self-standing arbitration panel opens the possibility to set up standard procedural rules and to create a panel of arbitrators. It could also create a panel of independent arbitrators that would be balanced in terms of experience, nationality, and background on a pro bono basis. Such a panel could also initiate a training program for future arbitrators from developing countries and should address the issue of how to improve the transparency of the process. Such an initiative could remain within the MAP framework but with
greater flexibility of procedures. Also, it could create a panel of lawyers who could provide support to developing countries on a pro-bono basis. Such a panel could also initiate a training program for future arbitra-
tors from developing countries and should address the issue of how to improve the transparency of the pro-
cess. Such an initiative could remain within the MAP framework but with greater flexibility of procedures. The question of financing could be addressed in vari-
ous ways — for example, through an access fee for companies or as a small percentage of arbitral awards.

Some participants wishing to use the panel were concerned that institutionalized arbitration could influ-
ence the MAP in a way that the competent authorities are no longer willing to find a reasonable solution for the dispute. Other concerns were raised over the possi-
bility that the institution responsible for arbitration could develop over time a reputation for holding cer-
tain positions on international tax issues, which gives the competent authorities an idea in which direction an outcome under arbitration could go.

Many participants suggested that the multinational instrument foreseen under BEPS action 15 could be used to rapidly introduce arbitration provisions in already existing treaties. Once a broad network of arbitra-
tion provisions were in place, the OECD might take further action in providing the guidance in applying that procedure. It could either establish a multilateral framework for arbitration procedures or use the multi-
lateral convention in administrative assistance. This approach would have the advantage that it could be implemented even in the absence of a consensus among OECD and G-20 countries, since all that would be required is a “coalition of the willing.” As experience is acquired within this group of countries, other countries could be expected to join.

**Next Steps**

This seminar was part of a long-term program on arbitration in tax law. The papers prepared will be published in a book in July 2015, and a conference on arbitration will be held at WU on October 12-13, 2015, with the aim of discussing the topic before a wide audience of researchers, practitioners, and government officials. The conference will bring together many of the same participants, but also feature other leading experts in the field. The outcomes from the discussions have already been fed into the debate at the OECD and will provide input for the U.N. Tax Committee when it meets October 19-23 in Geneva. The ITIC and EY will also use the results in regional tax forums. The research staff of the Institute for Austrian and Interna-
tional Tax Law of the WU will continue to work on the technical issues that need to be addressed as more countries move toward introducing arbitration provi-
sions into their tax treaties.

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