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Some Critical Thoughts on the Introduction of Arbitration in Tax Treaties

Ana Paula Dourado & Pasquale Pistone*

Intertax offers the reader one more special issue, this time about arbitration procedures.

Arbitration has either been introduced or increased in almost every legal field in recent years, as a result of the huge amount of business in a cross-border context. We discussed in a previous editorial some of the forum shopping issues that are raised by access to fair justice in open economies.¹ The increasing importance of arbitration procedures shows that access to fair justice also raises issues of procedures' shopping.

Why do parties in a legal dispute choose arbitration? Arbitration is often concerned with a more efficient outcome, than the one that would result from judicial litigation remedies. Inefficiency can either be related to burdensome and lengthy procedures (double taxation issues, social security issues, private law litigation); to the difficulty by the courts in interpreting facts (e.g., quantification issues regarding the taxable base, such as transfer pricing issues); or to the difficulty by courts in interpreting facts that may damage the interests (also financial interest) of its sovereign state (tax issues dealt with under a tax treaty, including transfer pricing issues, expropriation regarding a foreign investor). In the latter situation, arbitration is also a condition to guarantee an outcome that complies with the law and therefore also a fair outcome to the taxpayer.

Arbitration has been traditionally considered to be incompatible with the rule-of-law principle where this principle requires a rigid application of the separation of powers principle, and where independent judicial courts are the ultimate instance to interpret the law. This is the case of tax law, where arbitration is only admissible in respect of issues concerning the interpretation of facts (such as quantification issues and transfer pricing issues). Moreover, arbitration regarding international tax issues is not considered to be incompatible with the rule-of-law,

since it works as a tiebreak instrument (Article 25(5) of the OECD Model subjects only the issues that arose on the basis of Article 25(1) to the arbitration procedure, i.e., cases of taxation not in accordance with the provisions of the convention) and it can be argued that in international matters, there is not a single 'natural judge'. It may be here recalled that the EU was at the forefront of arbitration in tax matters, by approving the Arbitration Convention (90/436/EEC) which set up harmonized procedural rules on binding arbitration, concerning transfer pricing issues. The EU was however not able to set up the European Court of Justice as the final interpreter of the Arbitration Convention, which means that we still lack a *supra* state court to judge on tax arbitration issues.

Proposals for arbitration and an international court have been put forward by Gustaf Lindencrona and Nils Mattsson, in a book in 1981, as they recall in their notes published in this Special Issue on Arbitration: A Contracting State shall, if a solution has not been found by other means, call for arbitration for the settlement of this dispute, and the arbitration procedure is initiated by a request for arbitration to the International Institute for Arbitration in Tax Disputes in Stockholm and shall follow the rules of that Institute. The award shall be binding on the Contracting States. The authors suggested that the Institute should be founded by the United Nations.

In this special edition, Jérôme Monsenego reflects about the designing arbitration provisions in tax treaties based on the US experience. His article analyses some of the features of the arbitration provisions included in the tax treaties concluded by the US in light of the recommendations of the OECD and the UN Model Tax Conventions.

Mandatory arbitration is foreseen in what Montenegro calls the second generation of the US treaties: in this context, the author recalls that OECD Model Tax

Notes

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¹ A.P. Dourado, Editorial: *Forum shopping in EC Tax Law in the context of legal pluralism: spontaneous order as the optimal solution or taxpayers rights to a code of legality?* 36 Intertax (2008).

Convention gives preference to the 'independent opinion' approach,² while the UN Model Tax Convention favours 'baseball arbitration'.³

He contends that the differences emphasized between the arbitration provisions included in the tax treaties concluded by the US and Article 25(5) of the Model Tax Conventions may be of interest to countries considering different options for designing arbitration provisions in their tax treaties.

Michael Lang reflects on the introduction of mutual agreement and arbitration procedures regarding application of a Directive, including a Directive on the distribution of taxation rights, in order to avoid double taxation (Lang refers to a working paper presented on 12 April 2013, during a 'Stakeholder Meeting on Direct Taxation'). The author questions the compatibility of the aforementioned procedures with the monopoly of the ECJ in interpreting EU Law. According to the author, as long as the national court is free to agree to the introduction of a mutual agreement procedure or refer to the ECJ outright, there is no violation of EU law. If the competent authority of a Member State is informed that a question on the interpretation of a national provision based on the Directive on the avoidance of double taxation is pending before a national court, the responsible authority may have the possibility to request that the national court does not refer the case to the ECJ until a mutual agreement procedure is introduced and concluded. In the author's opinion, the decisive factor here is that the national court is not obliged to comply with this request.

In turn, Sven-Olof Lodin offers the reader his views on how does the EU-arbitration convention function in practice, the role of the representatives of the disputing states, the role of the independent members. He shares his practical experiences of being a member of two advisory (arbitration) commissions.

The situation of Mutual Agreement Procedures (MAP) and arbitration regarding tax treaty issues in developing countries differs from the movement in the EU and the OECD. In his article ('Mutual Agreement Procedures in Tax Treaties -Problems and needs in developing countries and countries in transition'), Carlo Protto discusses some difficulties that developing countries face when dealing with MAP cases and arbitration clauses. The lack of field experience and material and human resources, as well as tight budgets normally impede the competent authorities in developing countries to enter in MAP and arbitration: beyond the problem of expertise, they face routine obstacles such translations, travel and accommodation expenses for face-to-face meetings with other competent authorities.

Michael Lennard considers some of the obstacles that developing countries face in considering tax arbitration. He considers the importance of confidence building and a partnership approach, as well as the role of regional and international organizations in supporting developing countries.

As the article on 'Investment Treaty Arbitration – A Brief Overview' illustrates (by Kaj Hober), the development of international investment law is currently based on investment protection treaties (especially, on the so-called bilateral investment protection treaties (BITs)). The vast majority of BITs have clauses providing for investor-state arbitration. The BITs entitle investors to start arbitration against the host State. In addition to the BITs, there are multilateral investment protection treaties providing for investor-state arbitration (e.g., the Energy Charter Treaty (ECT) and the North American Free Trade Agreement (NAFTA)).

Manfred Pörtl and Bernhard Spiegel, dedicate their article to arbitration under international social security instruments. They explain the EU binding provisions that contain a comprehensive coordination of the different social security schemes of the Member States and the corresponding dispute settlement rules (Article 71 of the Regulation sets up the 'Administrative Commission for the Coordination of Social Security Systems'). This Commission deals with all administrative questions and questions of interpretation arising from the provisions of the Coordination Regulations, or from any agreement or arrangement. The competent institutions and authorities have to cooperate to resolve all disputes. If this does not lead to a solution the Administrative Commission, an EU body in which all Member States and the European Commission are represented, can decide on the issue (which does not include the possibility of enforcement of that decision). In a last step it is up to the courts to decide. However, as decisions of the Administrative Commission are adopted by government representatives of Member States they create a strong political obligation for governments to follow them. EU Member States have also concluded bilateral agreements providing for some coordination in social security issues in order to safeguard entitlement to benefits of persons with careers in two States. The agreements concluded by Austria contain also specific provisions on arbitration.

We think this group of articles published at our Journal and resulting from a joint Conference from the Uppsala University and the Institute for Austrian International Tax Law (WU Vienna University),⁴ illustrate the advantages of arbitration as well as the different challenges it still poses in different fields of law and categories of countries.

Notes

² See para. 4 of the annex to the commentary on Art. 25 of the OECD Model Tax Convention.

³ See para. 4 of the annex to the commentary on Art. 25(5) (alternative B) of the UN Model Tax Convention.

⁴ In association with the Swedish IFA Branch, held on 22 Aug. 2013, in Uppsala.

We would also like to highlight that in the context of addressing BEPS, arbitration will become the most effective solution for the problems taxpayers will face. Stronger actions by States require stronger protection of the taxpayers' rights. Although tax arbitration may not be the ideal means to build up international case-law on the interpretation of tax treaties, it is one of the current best

solutions at hand, since it avoids a unilateral outcome in case of litigation. A condition for the credibility of arbitration decisions is their publication. In this manner they could constitute the embryo of a future uniform and independent interpretation of international tax law, and set up the grounds for an international tax court.