As the world’s economy becomes ever more integrated, international tax disputes have grown in frequency and importance. Yet until recently, little had changed in the mechanism by which such disputes are resolved. The efficient functioning of the mutual agreement procedure (MAP) contained in most income tax treaties remains subject to the variable input of contracting states, and in some cases taxpayers still struggle to alleviate double taxation.

One solution to this problem for businesses operating in multiple jurisdictions is tax arbitration, which, due to a variety of policy decisions, international initiatives and judicial precedents is set to become a more dependable means of investor recourse.

In this article we examine these recent changes and explain why they will make the resolution of international tax disputes more timely and principled in the future. We also consider and compare the form of arbitration provided for in the OECD’s recently published Multilateral Instrument (MLI) as against other formats which are currently in use.1

Forms of tax arbitration
This note considers international tax arbitration in two different contexts.

First, tax arbitration as it applies to inter-state disputes. In this format, tax arbitration is carried out between states as they seek to allocate taxation rights over a particular source of income or profit. This form of tax arbitration serves the needs of multinational entities seeking to establish fiscal symmetry between deductions and inclusions, and thus the avoidance of double taxation. In particular we consider inter-state tax arbitration as it is available to investors under income tax treaties, and the European Arbitration Convention.2

Second, tax arbitration as it applies between foreign investors and host states. This form of tax arbitration commonly involves a treaty based claim that tax measures in a particular jurisdiction amount to expropriation or otherwise fail to deliver fair treatment. A number of successful taxation-related claims have been brought via bilateral investment treaties (BITs).3

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1 See A Mandate for the Development of a Multilateral Instrument on Tax Treaty Measures to Tackle BEPS (OECD 2015), and Multilateral Instrument To Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (OECD 2016), hereinafter Multilateral Instrument.
3 One may also see tax-related contractual claims arising under long-term concession or similar agreements that codify fiscal terms and/or provide for tax stabilisation. Such a contractual framework can provide effective protection for investors/taxpayers, but further consideration of this option lies outside the scope of this article.
The Mutual Agreement Procedure (MAP)

Article 25 of the OECD Model Convention provides that if a taxpayer considers that the actions of one or more contracting states will result in him being taxed 'not in accordance with the convention' then he may present his case to the 'competent authority' of which he is a resident. The relevant competent authority is then under an obligation 'to endeavour' to resolve the case by mutual agreement with a view to the avoidance of such tax which is not in accordance with the convention. Importantly, it is only where taxation not in accordance with the convention requires input from both contracting states in order to be alleviated that the MAP process is engaged. Where such taxation arises solely due to the actions of one contracting state, that contracting state shall unilaterally grant such adjustments or reliefs as remedy the iniquity. This is the essence of the MAP process.

Issues with MAP

Since its inclusion within the OECD’s Model Convention there have been a number of issues with the MAP process and taxpayers have struggled to enforce their rights through its provisions. As one prominent practitioner has noted MAP in its current format is a ‘black hole of taxpayer rights’.

Certainty

The principal limitation of MAP is that it is a system of consultation rather than litigation; it provides that contracting states will merely 'endeavour' to agree a resolution to the issue in dispute, rather than that they have a fixed obligation to do so. This means that whilst taxpayers must bring a MAP request within three years of the date on which they are first notified of taxation not in accordance with the relevant treaty, there is no fixed timeline for conclusion of a MAP case. As such when compared against established international fair trial standards, the MAP process fares poorly. Under MAP there is no 'right to a court', given that reference to MAP is at the discretion of the relevant competent authorities and there is also no right to determination within a reasonable period of time.

The official MAP statistics suggest that the duration of MAP claims is relatively brief. The average time period for closure was 20.47 months in the 2015 reporting period, a reduction as against 2014 when the figure was 23.79 months. However, it does not necessarily follow from this that the taxpayer has achieved an equitable outcome in all cases. In some situations the MAP procedure is closed by an agreement to disagree, principally because the contracting states are reluctant to establish precedent which could be detrimental to their respective economies. It should also be noted that the official MAP statistics rely on self-reporting and measure only ‘average completion times’ which means cases which simply languish are excluded from the dataset. To this extent the anecdotal evidence that MAP works far better in some states than in others is not necessarily reflected in the data. For example, discussions involving the UK, US and Canadian competent authorities are widely understood to run more smoothly than negotiations involving other governments.

5 OECD Model Tax Convention on Income and on Capital: article 25(2) (OECD, 2010).
8 OECD Model Tax Convention on Income and on Capital: Commentary on article 25 para 2 (OECD, 2010).
9 OECD Model Tax Convention on Income and on Capital: article 25(3) (OECD, 2010).
Opacity

MAP is also a relatively opaque process. Under the MAP process once a taxpayer has presented its case to a member state the procedure takes place ‘henceforward at the level of dealings between States, as if, so to speak, the State to which the complaint was presented had given it its backing’. This leaves taxpayers in the dark as to how their claim is progressing or as to whether their position with regard to the relevant issues has been adequately articulated.

Inequitable outcomes

In circumstances where two contracting states have multiple ongoing MAP procedures with each other at a given time, the temptation exists for them to engage in ‘horse trading’ by which all outstanding cases are resolved at a single swipe. These so called ‘package deals’ allow states to strike a bargain based on the aggregate levels of taxation in dispute, however individual cases may not be considered fully or objectively on their own merits. This form of resolution can have particularly harmful consequences for taxpayers where the rights to tax their income are being allocated as between two jurisdictions with drastically different headline rates of taxation.

MAP and BEPS Action 14

Given the perceived shortcomings of the MAP process, Action 14 of the OECD’s recent initiative to prevent Base Erosion and Profit Shifting (BEPS) aspires to make dispute resolution more effective. In particular, the OECD’s final report on Action 14 published in October 2015 comprised a variety of minimum standards and best practices which were designed to improve MAP. Certain aspects now find formal expression in the MLI (set forth below).

The distinction between ‘best practices’ and ‘minimum standards’ is an important one. Minimum standards were accepted by all countries adhering to the outcomes of the BEPS project as appropriate. In contrast, best practices did not receive the unanimous consent of all states involved in the BEPS process and their implementation remains subject to the discretion of each state. The OECD describes best practices merely as a term used to describe ‘what is generally thought to be the most appropriate manner to deal with a MAP process or procedural issue’.

The Action 14 final report contained three minimum standards.

1. States should ensure that treaty obligations related to MAP are fully implemented in good faith and that MAP cases are resolved in a timely manner. In practice this obliges states to incorporate paragraphs 1 to 3 of Article 25 of the OECD’s Model Convention into all of their income tax treaties – provisions which set out the fundamental MAP mechanics.

2. States should ensure administrative processes promote the prevention and timely resolution of treaty-related disputes. The upshot of this minimum standard is that states must provide guidance on the MAP process and ‘adequate resources’ to authorities adjudicating, deciding and negotiating MAP claims.

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3. As a result of the vested interest which states have in the success or failure of a MAP request, the third minimum standard provides that taxpayers should be able to submit a MAP request to either of the relevant states (not merely the state in which the taxpayer is resident). It also provides that the competent authorities of both states should be able to offer their views on whether a MAP request should be accepted or rejected before a decision is made. Both of these propositions are designed to allay taxpayer concerns that a single state retains absolute discretion to judge a MAP request not to be ‘objectively justified’ on reception and thus unworthy of further review in the MAP procedure. The third minimum standard’s purpose is to ensure both relevant states are involved in deciding whether a MAP request is worthy of consideration and to prevent arbitrary outcomes. This is an improvement on the prior regime, but the MAP procedure remains a bilateral inter-state process over which a taxpayer may well have little influence. However, exceptions may arise. For example, in a recent US–UK MAP the taxpayer and its advisers were permitted to be ‘in the room’ on occasion, together with the IRS and HMRC.

Action 14 also contains various best practices which garnered insufficient support from the OECD’s members to be minimum standards. Of these, perhaps the most important for taxpayers provides that contracting states should take appropriate measures to suspend the collection of tax when a MAP request is pending. The best practice further provides that the suspension of collections should be available under the same conditions as apply to a person pursuing a domestic remedy. The application of this best practice for taxpayers is an important one given the potentially disadvantageous cash flow consequence which double taxation carries whilst MAP is ongoing.

Whilst these changes are to be welcomed, the fanfare which surrounds the BEPS project gives a misleading view of the Action 14 proposals relating to MAP as revolutionary or new. For the most part they do not mark a significant break with past OECD policy. Many of the minimum standards and best practices which appear in the Action 14 Final Report have been suggested standards of general applicability since at least 2007 when they first appeared in the OECD’s Manual of Effective Mutual Agreement Procedures.19

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Inter-state tax arbitration under tax treaties

Notwithstanding the recent developmental steps taken in relation to the MAP procedure, the gold standard for inter-state tax dispute resolution continues to be mandatory binding arbitration, which carries two important consequences for taxpayers seeking just treatment. First, it provides certainty of resolution where contracting states cannot agree on an issue, and second, it offers a deadline for the resolution of issues which would otherwise have no fixed time limits under MAP.

A provision for arbitration was first added to the OECD Model Convention in 2008 in article 25(5). It reads as follows:

‘Where, (a) under paragraph 1 [a MAP request], a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and

(b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 [the MAP process] within two years from the presentation of the case to the competent authority of the other Contracting State, any unresolved issues arising from the case shall be submitted to arbitration if the person so requests.’

The drafting adopted by the OECD in article 25(5) of the Model Convention provides for mandatory binding arbitration, as opposed to ‘optional’ arbitration which is present in certain income tax treaties. Under optional arbitration agreement is reached on a case by case basis whether disputes should be put to arbitration, which enables a degree of discretion to be retained by contracting states. In contrast under mandatory binding arbitration the agreement to arbitrate is made prior to the existence of an actual dispute and requires arbitration in all cases where an issue has not been resolved. In addition to the OECD Model, mandatory binding arbitration has also been adopted in numerous recently signed income tax treaties.

From a taxpayer’s perspective the growing number of income tax treaties which offer mandatory binding arbitration is encouraging, and goes some way towards meeting the OECD’s stated aim of providing taxpayers with ‘certainty’ in relation to international tax disputes. The consent requirement in ‘optional’ arbitration allows each contracting state to exclude from the arbitration procedure cases which it considers unfavourable to its interests. It also disincentivises taxpayers from investing time and money in the MAP process if contracting states retain a discretionary right to forestall or prevent the final resolution of a dispute. To this extent a merely optional arbitration procedure does not provide adequate protection as against the lack of an obligation for contracting states to reach an agreement in the MAP procedure. Indeed little practical utility rests in treaties which express the hope that contracting states might decide to arbitrate a dispute, and delays will be inevitable were such arbitration provisions ever to be put into effect due to the need to negotiate each arbitration agreement on a case-by-case basis.

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20 OECD Model Tax Convention on Income and on Capital article 25(5) (OECD, 2010)
However, the form of arbitration adopted by the OECD Model by no means allays all prior issues with the MAP system. The link between MAP and arbitration and the fact that arbitration under the OECD Model only operates as an extension to the MAP process arguably weakens its effectiveness as a vehicle for taxpayer assertion of rights. Under the OECD Model Convention mandatory binding arbitration is triggered where the ‘competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 [the MAP process]’, which means that the same barriers to entry which apply to taxpayers seeking redress under the MAP system are of relevance to taxpayers seeking arbitration. That is, contracting states may cut off the potential arbitration of an issue in dispute before the quasi-duty under MAP for contracting states ‘to endeavour’ to resolve the dispute comes into existence. Prior to that point contracting states must judge whether a MAP request ‘appears to it to be justified’ before taking it up. If a contracting state considers a taxpayer’s request not to be justified then one of the conditions to the MAP process is not met and, thus, it follows that the issues in dispute cannot proceed to mandatory binding arbitration.

Arbitration as it appears in the OECD Model Convention also has another interesting feature by which it can be contrasted with arbitration as more commonly understood. Mandatory binding arbitration cannot be applied by taxpayers to resolve disputes in their entirety; instead it can only be applied to outstanding or unresolved ‘issues’ which form part of disputes in the wider MAP process. The trigger for the commencement of arbitration under the OECD’s model convention is the failure of contracting states to resolve an issue within two years of it first being presented under MAP. To this extent arbitration under the OECD model convention functions as a backstop to the MAP process and is not a standalone vehicle for taxpayer recourse.

The narrowly drawn role which arbitration plays in the resolution of tax disputes under many income tax treaties and the OECD Model Convention carries a number of important implications for taxpayers. It has been suggested that if arbitrators are not ‘deciding’ on a case but effectively contributing objective expertise to break an ‘issue’ roadblock, the interaction between MAP and arbitration is likely to be a seamless one, and the outcomes derived from the process are likely to be more compatible with states’ laws. However, it is conceivable under this model that arbitrators may be tasked with opining on an issue which is premised on reasoning or a factual interpretation of the underlying dispute which they do not accept. Arbitrators cannot, as it were, look behind the MAP process presented to them and, thus, may be required to deliver an opinion which forms part of wider dispute resolution with which they disagree.

Arbitration as a subset of the MAP process also raises the question of what the consequences of an arbitral decision are. The OECD Model Convention provides that the decision is ‘only binding with respect to the specific issues submitted to arbitration’ which leaves contracting states with some scope independently to agree various aspects of the MAP process subsequent to an opinion being offered. The OECD Model Commentary also provides alternate language for states which wish expressly to permit competent authorities to depart from an arbitration decision where they can agree on a different solution. The EU Arbitration Convention also adopts this approach. It is possible to imagine drafting which provides for arbitral decisions to be binding on competent authorities and on the taxpayer to the exclusion of all other factors. However, it is also possible to imagine arbitral decisions which treaty provisions make merely advisory on competent authorities. In this way, the OECD model and the EU Arbitration Convention provide a compromise position between an arbitral decision which precludes further involvement from contracting states and one that provides a final and consistent resolution to an issue.

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Inter-state tax arbitration under the EU Arbitration Convention

In addition to tax treaties, arbitration is also available to taxpayers based in EU Member States under the EU Arbitration Convention which came into effect in 1995. Article 7 of the EU Arbitration Convention provides that if the competent authorities of two member states fail to reach agreement two years after a complaint is first submitted, they must establish an advisory commission that will deliver an opinion on eliminating the double taxation. After the opinion has been delivered, states have not more than six months to take a decision which will eliminate the double taxation in question. In practice this means either implementing the opinion or coming to an agreed solution as to how the dispute should be resolved.

Whilst the manner in which it implements binding outcomes is similar to that provided for under article 25(5) of the OECD Model Convention the EU Arbitration Convention has narrower parameters of application. Unlike income tax treaties, it only applies to transfer pricing disputes and disputes concerning the attribution of profits to a permanent establishment of a resident of one contracting state situated in another. The upshot is that many forms of double taxation fall outside this scope.

The EU Draft Proposal

Given the EU Arbitration Convention’s narrow operational scope, in October 2016 the European Commission released a draft directive which set out a mandatory binding dispute resolution mechanism which, on implementation, would apply to all forms of double taxation between member states. The EU Draft Proposal builds on the format of pre-existing resolution mechanisms under double taxation treaties in so far as it involves MAP combined with an arbitration phase with clear time limits and an obligation of result for all member states. The proposal applies to all taxpayers which are subject to (a yet to be specified) list of income taxes on business profits. However, the draft also contains an explicit carve out from usage in circumstances which characterise double non-taxation or cases of fraud, wilful default or gross negligence.

At its core the EU Draft Proposal is a three stage process towards resolution of inter-member state double taxation disputes: first, a complaints phase (where the complaint is made to both relevant member states by the aggrieved taxpayer), second a MAP phase (in the event both member states accept the complaint), and third a dispute resolution phase (in the event MAP fails or only one member state accepts the original complaint). Member states will be obliged by EU law to implement the terms of the directive into national law. On 6 February 2017 the Maltese Presidency of the Council of the European Union issued a note entitled BEPS: Presidency roadmap on future work, which sets out its priorities for future work on taxation.

The note states implementation of the EU Draft Proposal is a priority and that the Council’s aim is to reach agreement on the proposal by the end of June 2017. Notwithstanding Brexit, the UK government has already made public its support for the EU Draft Proposal and noted that it welcomes the broader application of arbitration to instances of double taxation.

The operation of the EU Arbitration Convention, and following implementation, the EU Draft Proposal on dispute resolution, is or will be monitored and overseen by the EU Joint Transfer Pricing Forum (JTPF). The JTPF has one representative from each member state’s tax administration and 18 non-government organisation members. It is chaired by an independent chairperson and, in particular, advises on the Code of Conduct for the effective implementation of the EU Arbitration Convention. Under the EU Draft Proposal, the JTPF will also collect data on closed, initiated and pending cases brought by taxpayers alleging double taxation.
The changing face of international tax arbitration
March 2017

The Multilateral Instrument

The minimum standards set out in the OECD’s BEPS project will be incorporated into income tax treaties through the Multilateral Instrument which is provided for under BEPS Action 15, the final text of which was released in November of 2016. The Multilateral Instrument is designed to modify existing bilateral tax treaties in a synchronised and efficient manner, and to avoid a lengthy period of ad hoc negotiation.

Although mandatory binding arbitration was not one of the minimum standards contained within any of the BEPS final reports, the Multilateral Instrument does contain various arbitration provisions which states may choose to adopt. On offer is a menu of different options for the form which arbitration may take, ranging from the process by which an award is made to which agreements contracting states wish the Multilateral Instrument’s provisions to cover.

Arbitration under the Multilateral Instrument

The Multilateral Instrument preserves optionality for signatory states with respect to arbitration provisions in at least three different ways. In the first instance the Convention does not automatically incorporate arbitration provisions into income tax treaties. Instead states are given the option to choose to apply the arbitration provisions in the Multilateral Instrument to their income tax treaties. This means that even if a state plans to sign and adopt the Multilateral Instrument, it does not need to incorporate the arbitration provisions.

Further where states have elected into the arbitral regime in the Multilateral Instrument, it does not necessarily follow that that arbitral provisions will be incorporated into any one of their income tax treaties. That final step only occurs where a contracting state’s counterparty to a given treaty has also made an equivalent election. The Multilateral Instrument does not allow states to amend their treaties unilaterally.

Secondly the Multilateral Instrument’s arbitral provisions are only ever expressed to apply to certain ‘Covered Tax Agreements’ which states may select. States may in this regard exempt particular treaties from arbitral provisions, whilst electing to apply them in relation to others. The OECD suggests that this optionality is preserved for cases where a particular treaty already contains a bespoke set of arbitral provisions. However, it is also possible to imagine states utilising the exemption to carve out particular treaties and jurisdictions with which states anticipate particular number of contentious disputes or other difficulties.

Thirdly, the Multilateral Instrument provides states with a degree of flexibility as to the form of arbitration adopted. The default mode provided for is ‘baseball arbitration’ (on which please see below), however contracting states may alternatively elect for a more orthodox ‘reasoned opinion’ format for resolution of their disputes. If both contracting states which are party to an income tax treaty have agreed to incorporate arbitration provisions into a treaty, but wish to opt out of ‘baseball arbitration’, the ‘reasoned opinion’ format will prevail as between the two parties.

40 Multilateral Instrument to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (OECD 2016) article 26(1).
41 Multilateral Instrument to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (OECD 2016) article 18(1).
42 Multilateral Instrument to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (OECD 2016) article 24(2).
43 Explanatory Statement To The Multilateral Instrument To Implement Tax Treaty Related Measures To Prevent Base Erosion And Profit Shifting (OECD 2016).
Form of arbitration

The Multilateral Instrument’s provisions on the type of arbitration proposed is the most striking outcome of Action 14. For contracting states which do elect for the arbitration provisions to apply to their income tax treaties, the default mode of arbitration under Article 23(1) of the Multilateral Instrument is ‘last best offer’ or ‘baseball arbitration’ (which, notoriously, takes its name from the method used by major league baseball teams to set the remuneration of players). Under baseball arbitration the arbitral panel picks between the last best offers (usually fixed monetary amounts) submitted by contracting states rather than applying a reasoned decision of its own. Or as the Multilateral Instrument puts it: ‘the arbitral panel shall select as its decision one of the proposed resolutions for the case submitted by the competent authorities with respect to each issue… and shall not include rationale or any other explanation of the decision’. As such, under this arbitral process the authority of arbitrators is severely restricted. They are not allowed to substitute a judgment of their own for the monetary submissions made by each of the contracting states.

Baseball arbitration’s procedural form carries a number of important effects. It greatly reduces the costs which are associated with arbitral proceedings and dramatically increases the speed with which a decision can be rendered. This is a consequence not only of the fact that the arbitral process simply involves selecting one of two estimates (and no further reasoning), but also due to the delicate balance of game theory which should preclude outlandish claims from submission. This latter point was a particular aim of baseball arbitration which was adopted by contracting states following the perceived trend in ‘reasoned opinion’ arbitrations to split the difference between the views of opposing parties. This could create a perverse incentive for contracting states towards more extreme positions in order to create a more advantageous ‘middle’ point which the arbitrators could select.

However, notwithstanding these benefits, there are evidently some shortcomings with baseball arbitration as a process. If two contracting states were to submit unreasonable proposals for decision, arbitrators would be required to choose one of them creating an unjust result. Baseball arbitration is also ill-suited to scenarios where an exact monetary value is not the primary issue in dispute between contracting states. Where for example the interpretation of a treaty term or another qualitative issue falls to be determined, the simple election of a monetary value may not be possible. It has also been argued that the absence of a rationale for any particular decision makes the process opaque and increases its susceptibility to bias.

The Multilateral Instrument is not the only vehicle through which baseball arbitration has been implemented. It is also the approach favoured in the US government’s model income tax treaty, and has, for example been incorporated as the form of arbitration in the US–Canada income tax treaty. The UK too has also recently included baseball arbitration via a protocol to its income tax treaty with Canada. However, we note that one exception to this general trend is the EU Draft Proposal which makes no mention of ‘last best offer’ or ‘baseball’ arbitration, and instead sets out a framework which is tailored to the ‘reasoned opinion’ format.

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44 Multilateral Instrument To Implement Tax Treaty Related Measures To Prevent Base Erosion And Profit Shifting article 23(1)(c) (OECD 2016).
46 EU Draft Proposal, see article 13(1) and references in article 13(2) to the arbitral commission ‘drawing up its opinion’.
**Optional arbitration**

Importantly the Multilateral Instrument does not allow contracting states to elect into the arbitration regime with respect to an income tax treaty and then decide on an ad hoc basis whether individual matters should fall within the arbitral scope. In this respect the Multilateral Instrument differs from the recently amended UK–Canada treaty which provides that arbitration of a matter will go ahead unless the competent authorities agree that the particular case is not suitable for determination by arbitration.\(^\text{47}\) This added degree of state discretion is not present in other income tax treaties which have recently been revised, such as by the UK–Canada memorandum of understanding signed in 2010.\(^\text{48}\) Nor is it present in the EU Draft Proposal which makes provision for the automatic establishment of an advisory commission where competent authorities have failed to reach agreement under the MAP process.\(^\text{49}\)

**Selecting arbitrators**

Under the Multilateral Instrument the two contracting states in dispute each select an arbitrator and a third arbitrator is selected by those first two arbitrators to act as chair person. If the first and second arbitrators fail to select a third, the agreement goes on to provide that a selection will be made by the Director of the OECD’s Centre for Tax Policy and Administration. The same procedure also applies if for any reason it becomes necessary to replace one of the arbitrators. This is also the approach adopted by the OECD model arbitration agreement.\(^\text{50}\)

The selection of arbitrators raises an important question about impartiality. At present the OECD’s model arbitration agreement places no restrictions on persons whom contracting states may appoint as arbitrators.\(^\text{51}\) Further the position under the EU Arbitration Convention and various income tax treaties is that key roles on the arbitral panel may be reserved for those in the employ of each contracting state’s competent authority.\(^\text{52}\) This is also the position under the EU Draft Proposal which makes explicit provision for two representatives of each competent authority concerned to be on the advisory commission.\(^\text{53}\)

The presence of individuals with direct ties to one party on arbitral panels casts into doubt the objectivity of decisions reached and militates against the use of prior arbitral decisions, where published, as guidance on future disputes by contracting states. This has always seemed troubling given the axiom that no one should be a judge in his own cause (\textit{nemo iudex in causa sua}). It is also doubtful what benefit could be added by a non-neutral arbitrator, given as contending parties the relevant competent authorities will have the opportunity to express their views during the course of an arbitration.\(^\text{54}\)

The Multilateral Instrument marks a step forward in this regard in so far as it provides that ‘each member appointed to the arbitration panel must be impartial and independent of the competent authorities, tax administrations and ministries of finance of the contracting jurisdictions’.\(^\text{55}\) As a step in the right direction (albeit falling short of requiring complete impartiality), in an exchange of notes in August 2015 the UK–Canada income tax treaty was amended with respect to arbitration and included the following provision: ‘the members appointed will not have any prior involvement with the specific matters at issue in the arbitration proceeding for which they are being considered as members of the arbitration board’. It is possible still to envisage members of the relevant tax authorities being appointed under the UK–Canada language, and as such the MLI appears to do a more comprehensive job of safeguarding taxpayer interests.

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\(^{49}\) EU Draft Proposal, article 6(3).

\(^{50}\) OECD Model Tax Convention on Income and on Capital: Commentary on article 25 (annex) (2010).


\(^{53}\) EU Draft Proposal, article 8(1).


\(^{55}\) Multilateral Instrument, article 20(2)(c).
Confidentiality

Also of some importance to the efficient and principled resolution of arbitral matters are the confidentiality provisions contained within the relevant treaty or agreement which govern arbitral awards. One of the perceived advantages of arbitral awards is that even if they lack value as precedent (which the OECD presently specifies in its sample agreement), taxpayers in future disputes will be able to gain some guidance from their publication.56 In particular publication is hoped to prevent future disputes, assist consistency in decisions and raise awareness about arbitration which should encourage its use.57 However, little or no benefit is likely to accrue where the decision published is the mere selection of a quantitative award under baseball arbitration. The real benefit from publication is to be gleaned when the arbitration's subject matter is qualitative in nature, and the arbitral award takes the form of reasoned opinion.

For this reason the model arbitration agreement provides that ‘with the permission of the person who made the request for arbitration and both competent authorities, the decision of the arbitral panel will be made public in redacted form without mentioning the names of the parties involved or any details that might disclose their identity’.58 Publication is also the default position under the UK–German treaty which provides that an arbitral award shall be made public provided that the names of the parties and any details which might confirm their identity are redacted.59 The EU Draft Proposal also provides that ‘subject to the consent of each of the taxpayers concerned’ the competent authorities shall publish any final decision rendered and further adds that even where an objection is raised, an abstract of the decision shall be published.60 In contrast the Multilateral Instrument perhaps falls short of this best practice in so far as it merely provides that an arbitral decision (where one is rendered) shall be delivered to the competent authorities of the contracting states.61 Thus, there is no equivalent presumption of publication and no equivalent tendency towards creating a useful set of guidelines on which taxpayers may rely.

Timing Limits

In order for a taxpayer to commence MAP and, in turn, arbitration under the Multilateral Instrument, a case must be presented within three years from the first notification of the action which results in taxation not in accordance with the relevant income tax treaty.62 This time period for action is also replicated under the OECD Model, the EU Draft Proposal and the EU Arbitration Convention which also provide that a MAP case must be presented within three years from first notification.63 In all three cases, because arbitration is a subset of the MAP process, the time limits for instigating an arbitration claim are derived from the time limits for commencing MAP.

In what is probably the first decision rendered by a court in the European Union on the European Arbitration Convention, the exact meaning of ‘presentation’ of a case and its application to the relevant time limits was recently considered.64 In that instance the Danish tax authorities denied a taxpayer recourse to the MAP process (and, thus, also to arbitration) on the grounds that the form of submissions made which requested MAP were insufficiently detailed as to constitute ‘presentation’ within three year period set out above. The taxpayer contended that article 6(1) of the EU Arbitration Convention contained no authority for the term ‘presentation’ to carry an embedded requirement for such specific detail.

60 EU Draft Proposal, article 3(1) and article 3(3).
61 Multilateral Instrument, article 2(3).
62 Multilateral Instrument, article 16(1).
63 See OECD Model Tax Convention on Income and on Capital article 25(1) (OECD, 2010), European Arbitration Convention article 6(1) and EU Draft Proposal article 3(1).
64 Denmark: High Court, Western Division, Case number B-1414-15, H v Ministry of Taxation, SKM.2016.354.VLR.
The Danish High Court ultimately found for the taxpayer; however the case serves to outline two key stumbling blocks in the development of arbitral provisions. The first is that some jurisdictions may be willing to use uncertainties in the procedural form of arbitration (and MAP) clauses to deny taxpayers their right to contest inequitable taxation. The second is arbitral provisions are most useful to taxpayers when they provide granular detail on the practical application of dispute resolution mechanisms. On this latter point the EU Draft Proposal excels; it usefully stipulates the information requirements which need to be completed for an admissible complaint and sets out a detailed framework called the ‘rules of functioning’ by which an arbitral panel is to be constituted and administered.65

The European Council, via the EU Joint Transfer Pricing Forum, has provided useful recent clarifications on both of these issues in relation to the EU Arbitration Convention. Draft recommendations were made to Member States to consider providing domestic legal remedies for determining whether the denial of access to the EU Arbitration Convention by competent authorities is justified.66 States should also ensure that additional guidance has been provided which draws a distinction between the first notification of an action under Article 6(1) and submission of a case for the purposes of Article 7(1).

65 EU Draft Directive article 3(3) and article 10(1).
68 Multilateral Instrument (OECD 2016) article 19(4)(c).

Arbitration and domestic law

The interaction between arbitral proceedings and the available taxpayer remedies under domestic law is one of the most interesting areas of inter-state tax arbitration. Under most income tax treaties arbitral awards (even where notionally final or binding) may be set aside if in conflict with present or subsequent decisions rendered in the domestic law of a contracting state. For example, the Multilateral Instrument provides that arbitral decisions are final and binding except where: (i) a person directly affected by the decision chooses to pursue litigation on the issues in a court or administrative tribunal, or (ii) where the courts of one of the contracting jurisdictions hold the decision to be invalid.68 Similarly the OECD Model Convention also provides that a taxpayer may present a claim for MAP whether or not he has a claim or has commenced litigation under domestic law.69 Thus a case may be presented and accepted for MAP while domestic remedies are still available.70 In such circumstances the relevant contracting states generally request the suspension (but not the cessation) of domestic remedies while MAP is implemented. This is presently the position of HMRC, with the consequence that taxpayers may recommence or initiate domestic law proceedings where they are unhappy with an arbitral decision.71

The converse situation in which domestic remedies are exhausted and the taxpayer subsequently elects to pursue MAP is murkier. The OECD Model Commentary makes specific provision under which states may elect to permit settlement through the MAP process to deviate from final court determinations.72 Yet this is seldom implemented. In fact many states prohibit parallel proceedings, and where domestic remedies have been exhausted provide that a person may only pursue remedies under MAP to obtain relief from double taxation in the other state.73
At first sight the EU Draft Proposal offers the taxpayer greater room for manoeuvre on this issue. It states that even where a decision causing double taxation ‘becomes final according to national law, this shall not prevent taxpayers from having recourse to procedures provided for in the proposal’.74 But that position is qualified with regard to states where national law does not allow a dispute resolution to derogate from the decision of judicial bodies, in which case arbitration may only be initiated where a ‘final’ decision has not been rendered (and domestic proceedings if commenced have been withdrawn).75 To this extent, none of the avenues to arbitration reviewed by this article offer taxpayers an unqualified opportunity to override decisions rendered in national law, but depending on the constitutional specifics of the relevant contracting states, this possibility may exist.

On this point, HMRC does note that even where a claim has been settled under domestic law, the UK competent authority would expect, on request, to take the matter up under MAP.76 However, this construction does not mean that domestic law can be overridden via MAP. Rather it suggests that where a final determination under domestic law requires relief to be applied by another contracting state to prevent double taxation such relief can be applied for under MAP.

Deviating from the arbitral decision

Under the EU Arbitration Convention, the EU Draft Proposal and the UN Model Convention contracting states have the option not to implement an arbitral decision after it has been rendered, but to agree on an alternative course of action. Article 12(1) of the EU Arbitration Convention and Article 14(2) of the EU Draft Proposal provide that contracting states are obliged to implement an arbitral decision only if they have failed to reach an alternative agreement six months after the Advisory Commission has delivered its opinion. This is also the position under article 25(5) of the UN Model. In contrast, the OECD Model Convention provides that competent authorities have to implement the arbitration decision through mutual agreement, unless a person directly affected by the case does not accept the mutual agreement. That said, a paragraph is included within the OECD Model Commentary which contracting states may elect to include within their income tax treaties which has the effect of allowing competent authorities to deviate from arbitral awards where they can agree to do so.78

This is also the approach adopted by the MLI which contains optional provision under which an arbitration decision may not be implemented once rendered if contracting states agree on a different resolution of all unresolved issues within three months of the decision being delivered.79 However one might query whether as a practical matter competent authorities are likely to agree an alternative resolution to a dispute after an arbitral award has been rendered, if they were not prepared to do so prior to that date.

Enforcing the arbitral decision

Under the OECD Mutual Agreement arbitral awards are incorporated into the mutual agreement procedure, and as such the normal rules for the enforcement of arbitral awards do not apply. The legal status of the arbitral convention is, thus, a matter for the domestic law of the respective states concerned. For example, in the UK where a solution or mutual agreement is reached under the terms of a UK tax treaty, it will be given effect notwithstanding anything in any enactment in accordance with section 124(2) of TIOPA 2010.80 Similarly, where a claim for relief is made in pursuance of an agreement or opinion reached under the EU Arbitration Convention, this is given effect by section 127(3) of TIOPA 2010. Internationally, the enforceability of the types of arbitral awards examined under this note will ultimately be a question of domestic law and the effectiveness with which treaty rights are transposed into legislation. As the EU Draft Proposal states: any ‘final decision shall… be implemented under national law of the Member States which as a result of the final decision will have to amend their initial taxation, irrespective of any time limits prescribed by the national law’.81

74 EU Draft Proposal, article 15(1).
75 EU Draft Proposal, article 15(4).
79 Multilateral Instrument (OECD 2016) article 24(2).
81 EU Draft Proposal, article 14(4).
Inter-state tax arbitration as adopted by contracting states

For the moment inter-state mandatory binding arbitration under income tax treaties remains more of an aspiration than a reality, notwithstanding the addition of Article 25(5) of the OECD’s Model Convention and the advances proposed by the Multilateral Instrument. The BEPS Action 14 recommendations do not include a minimum standard with regard to treaty arbitration and as yet arbitration provisions are included in only a minority of income tax treaties. Nonetheless the OECD does note that 20 states have independently declared their commitment to treaty arbitration and such countries were involved in more than 90 per cent of MAP cases as at the end of 2013.

At present there are approximately 200 tax treaties which contain some form of arbitration provision (out of a total of more than 3,000) and various states are making such inclusion a standard part of their bilateral tax treaty network (see, for example, the US Model Income Tax Treaty which now makes provision for arbitration). However, treaties which do provide for mandatory binding arbitration often have drafting which differs from that in the OECD Model Convention and which attaches more flexible conditions to its use. For example, the US–Canada Income Tax Treaty provides for arbitration ‘if... the case... is a particular case that the competent authorities agree is suitable for determination by arbitration’. As such the contracting states are only required to adopt binding arbitration in relation to particular forms of dispute which have been pre-approved.

Investor-state arbitration in non-tax treaties

It may be interesting to compare international treaties which do not have the regulation of tax affairs as their primary purpose, as they may also present tax arbitration opportunities. Traditionally this has taken the form of taxpayer action against contracting states under bilateral investment treaties (BITs), the aim of which is to protect investors from expropriation without compensation, discrimination and unfair and inequitable treatment. One important contrast to be drawn between this form of tax arbitration and arbitration pursuant to income tax treaties is that a taxpayer that qualifies as a protected investor under the BIT can directly bring proceedings against a contracting state. The taxpayer’s home state is not involved and does not act as a gateway to the claim being pursued, and the claim is not an inter-state claim between two contracting states. For taxpayers this presents a key advantage; the scope to direct proceedings in tax arbitration heightens the likelihood of effective recourse.

There are two potential obstacles to tax-related claims under BITs. The first is the recognition by many tribunals of the sovereign power of states freely to enact and change tax measures. As a result, it is generally difficult for investors to recover losses resulting from the bona fide application of measures of general taxation – something more, in the nature of arbitrary, discriminatory or otherwise exorbitant conduct is typically required. Second, the specific terms of BITs themselves may preclude claims relating to tax measures.

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83 OECD Ctr. for Tax Policy and Admin., Making Dispute Resolution Mechanisms More Effective, Action 14 – 2015 Final Report (OECD 2015), p10. The 20 states are Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States.
85 Convention between Canada and the United States of America with respect to Taxes on Income and on Capital (26 September 1980) article 26.
Varying BIT drafting
Tax-related claims cannot be brought to arbitration under all BITs, many of which expressly exclude their applicability to taxation matters. For example, the current BIT between Argentina and New Zealand provides that ‘the provisions of this Agreement shall not apply to matters of taxation in the territory of either Contracting Party. Such matters shall be governed by the domestic laws of each Contracting Party and the terms of any agreement relating to taxation concluded between the Contracting Parties’.  

However, other BITs attempt to strike a more subtle balance between the rights of investors and the rights of governments to control fiscal policy. One such example is the Japan–Vietnam BIT which provides that, except where expressly provided otherwise, the rights bestowed on investors under the treaty shall not cover taxation matters, but then goes on to specify a number of protections against discriminatory treatment or the imposition of performance requirements that do apply to taxation measures.  

Still other BITs expressly extend only some treaty standards of protection to taxation measures, such as the Netherlands–Mozambique BIT, which states that taxation measures will be guaranteed national treatment and most favoured nation treatment. Some tribunals have found that such a formulation is an implicit exclusion of claims based on other standards of treatment. In Mobil Corporation v Venezuela the Netherlands–Venezuela BIT did not explicitly exclude tax matters either in general or from the protection against fair and equitable treatment that was invoked by the investor. Instead, the BIT contained a provision like that in the Netherlands–Mozambique treaty described above. The tribunal found that, because the section of the treaty dealing with tax measures referred only to protections against discrimination and did not refer to fair and equitable treatment, one could infer the exclusion of claims relating to tax measures from the more widely drafted fair and equitable treatment provision.

Finally, other treaties, such as the Netherlands–Korea BIT, do not expressly exclude taxation from their remit, save to the extent those agreements which relate wholly or mainly to taxation are excluded from the most favoured nation clause. This is a relatively common and explicit exclusion, given that most favoured nation clauses would otherwise cut across the individually negotiated provisions in a contracting state’s network of income tax treaties.

90 Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Venezuela article 4 (22 October 1991).
91 Mobil Corporation (2014), para 235.
92 Agreement on the Promotion and Protection of Investments between the Government of the Kingdom of the Netherlands and the Government of the Republic of Korea article 3 (12 July 2003).
Forms of tax claim under BITs

Notwithstanding the above intricacies, which turn on the specific language and exclusions contained in each BIT, investors have succeeded on BIT claims relating to matters of taxation. Tribunals have also made clear that in principle taxation measures may amount to the expropriation of an investment.

In *EnCana Corporation v Ecuador*, an arbitration which concerned VAT refunds and the Ecuadorian oil industry brought pursuant to the Canada–Ecuador BIT, the tribunal found that ‘if a tax law is extraordinary, punitive in amount or arbitrary in its incidence... issues of indirect expropriation [would] be raised’.93 In a similar context under the United States–Ecuador BIT an arbitration tribunal determined ‘expropriation need not involve the transfer of title to a given property, which was the distinctive feature of traditional expropriation under international law. It may of course affect the economic value of an investment. Taxes can result in expropriation as can other types of regulatory measures’.94 However, whilst acknowledging the possibility in practice, tribunals have seldom found that taxation measures do amount to expropriation. In *EnCana Corporation* (2006), for example, the Tribunal indicated that such a claim was available in principle, but declined to find an expropriation on the facts.95

Historically, investors have had more success with claims based on discriminatory taxation or taxation measures implemented inconsistently with investors’ legitimate expectations. The latter such measures implicate the requirement of fair and equitable treatment, which ‘may be breached by frustrating the expectations that the investor may have legitimately taken into account when making the investment. Legitimate expectations may result from specific formal assurances given by the host state in order to induce investment’.96

By way of example, in *Occidental v Ecuador*, an investor claimed in relation to refunds of VAT levied on goods and services. The ‘participation contract’ at issue entitled the investor to refunds, and these were for a number of years regularly provided. When the Ecuadorian tax authorities issued resolutions denying all further applications for refunds and requiring the reimbursement of prior refunds, the investor brought a claim under the Ecuador–US BIT. The tribunal ruled that Ecuador had breached its obligation to provide national treatment – that is, treatment not less favourable than that provided to domestic taxpayers – because other companies involved in exporting goods, and in this way in like circumstances with the investor, were still entitled to receive VAT refunds. The tribunal also found that the investor had not received fair and equitable treatment because ‘[t]he tax law was changed without providing any clarity about its meaning and extent, and the practice and regulations were also inconsistent with such changes’ such that the legal and business framework lacked the required stability and predictability.97

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94 LCIA, 1 July 2004, *Occidental Exploration and Production Company v The Republic of Ecuador*, UN3467, para 86.
95 *EnCana Corporation* (2006), para 86.
96 Mobil Corporation (2014), para 256.
97 *Occidental Exploration* (2004), para 186.
Free trade agreements

In addition to BITs, free trade agreements also offer the opportunity for investors to bring arbitration claims in relation to tax disputes, subject to their application in the jurisdiction of taxpayer residence. For example, the North Atlantic Free Trade Agreement (NAFTA) and the Energy Charter Treaty (ECT) contain provisions prohibiting the expropriation of investor assets which, as with BITs, tribunals have construed to cover certain taxation measures.

Article 1110 of NAFTA states that ‘no party may... directly or indirectly... expropriate an investment of an investor of another party’. In Metalclad v Mexico the tribunal found that ‘expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property... but also... incidental interference with the use of property which has the effect of depriving the owner... of the reasonably-to-be-expected economic benefit of property’. The analogous provision in the ECT which prohibits expropriation is phrased even more broadly so as to cover ‘expropriation... or a measure or measures having equivalent effect’.

However, bringing arbitration claims under the ECT and NAFTA in relation to taxation measures is less than straightforward. Both agreements contain provisions which, in certain circumstances, bar investors from arbitrating matters of taxation which are alleged to be expropriation. Article 2103(6) of NAFTA provides that an investor must refer a taxation measure to the competent authority of the state in which it is tax resident and the competent authority of the state in which it is investing before submitting a claim to arbitration which alleges expropriation. If the competent authorities in both host and investor states then determine that the taxation measure is not a form of expropriation then this functions as a ‘tax veto’ on proceedings and the measure in question will not be arbitrated. The near equivalent provision in the ECT at Article 21(5) provides that the competent authorities shall have six months to determine whether the tax measure amounts to expropriation before arbitration can commence. After that time period, the arbitration panel may take account of any findings of the relevant competent authorities in its final determination.

The upshot of these provisions is that under both the ECT and NAFTA the competent authority of host and investor states may filter arbitral claims which allege that taxation measures amount to expropriation.

Concluding remarks

The arbitration of inter-state and investor–state tax disputes is a growing phenomenon. A large and increasing number of income tax treaties now provide for some form of arbitration mechanic as a means to resolve treaty disputes. Such provisions provide relief to taxpayers from the relative uncertainty of MAP and they are bolstered by the improvements to the bilateral tax treaty network which BEPS Action 14 initiates via the Multilateral Instrument.

Thanks to such developments, taxpayers will begin to acquire a more expansive armoury to deploy when taxed unfairly, especially where this is otherwise than in accordance with income tax treaties. Where mandatory binding arbitration is applied taxpayers will no longer be reliant on the mere ‘best endeavours’ of contracting states.

These improvements when combined with other avenues to binding settlement under the EU Arbitration Convention, the EU draft directive on a double taxation dispute resolution mechanism and various free trade agreements will make tax arbitration a more ready means of exerting taxpayer rights.

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98 ICSID, 30 August 2000, Metalclad Corporation v The United Mexican States, ICSID ARB(AF)/97/1, para 103.