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International Tax Arbitration

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Cross-border tax disputes are usually channelled through the "mutual agreement procedure", an informal negotiation between the tax authorities of the states involved. Arbitration has been suggested as an alternative, and is starting to be instituted. Arbitration will probably be a good "stick" against over-long mutual agreements, but it also seems to exhibit "carrot" features, such as finality, independence and greater taxpayer support. This article describes the developments and analyses the options that countries face. In the Australian context, the transfer pricing litigation environment and the FIN 48 accounting standard are considered, and the author calls on the Australian government to invite submissions on the prospect of arbitration clauses in Australia's tax treaties.

INTRODUCTION

Earlier this year, the Organisation for Economic Co-operation and Development (OECD) announced[1] that a mandatory arbitration provision will be inserted into its model tax treaty, on which most of the world's tax treaties are based.[2] This is a significant development in international tax dispute resolution; indeed, it inspires confidence in identifying "international tax dispute resolution" as a discipline at all. Compulsory adjudication was suggested as a solution to international tax disputes as early as 1895,[3] but it is only in the last 20 years that the arbitration movement has really gathered momentum, and the OECD's proposal is its first mainstream and global endorsement. The provision imposes a requirement for states to arbitrate, at the taxpayer's request, if a dispute is unresolved after two years of negotiation.

The task now is for Australia and other countries to evaluate how to incorporate the OECD's recommendation into their own tax treaty policies. Although international tax arbitration would appear to offer benefits, many tax authorities, including the Australian Taxation Office (ATO), are wary of it. It is true that arbitration of international tax disputes, while not unprecedented, is largely an unknown in practice and that, in developing the institution, various complicated issues arise for resolution. However, if it evolves in a considered and incremental fashion, international tax arbitration is likely to be an option that taxpayers will value.

This article has four parts. The first part considers the new paragraph to be inserted into the OECD model treaty. The second part explores the background to this development: the mutual agreement procedure is contrasted to nascent international tax arbitral institutions and other cross-border tribunals to illustrate the way that the tide is turning toward international tax arbitration. The third part examines the OECD's proposal in detail, analysing key issues such as the interaction between arbitration and domestic litigation, the structure of arbitrations and the appointment of arbitrators. The fourth part contains the author's conclusions on international tax arbitration both generally and for Australia specifically.

PART 1: AMENDMENT TO THE OECD MODEL TAX TREATY

The new paragraph, which will be added to Art 25, *Mutual Agreement Procedure*, of the OECD model tax treaty, reads as follows:

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[1] Organisation for Economic Co-operation and Development (OECD), *Improving the Resolution of Tax Treaty Disputes*, Report adopted by the OECD Committee on Fiscal Affairs on 30 January 2007 (2007) (OECD Report), http://www.oecd.org/dataoecd/17/59/38055311.pdf viewed July 2007.

[2] OECD, *OECD Model Tax Convention on Income and on Capital* (2003).

[3] Altman Z, *Dispute Resolution under Tax Treaties* (Amsterdam, IBFD Doctoral Series Vol 11, 2005) p 75.

5. Where,
   (a) under paragraph 1, 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 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. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.[4]

There is a footnote to the final sentence that provides assurance that countries need not include this paragraph in a treaty if they face legal or policy barriers to what it requires[5] and that, alternatively, they may modify it by removing the prohibition on arbitration in cases where the issues have already been considered by domestic courts.

Several explanatory paragraphs about the arbitration process will be added to the Commentary to the OECD model tax treaty (the Commentary) when the treaty changes in 2008.[6] Annexed to the Commentary will be a sample arbitration agreement.[7] Many of the issues raised in the Commentary and Annexure are discussed in this article.

PART 2: BACKGROUND

Traditionally, most international tax disputes have been channelled through what is called the mutual agreement procedure (MAP), an informal negotiation between the tax authorities of the states concerned. The MAP is authorised by the tax treaty between those states, and most countries have tax treaties with at least their major trading partners. While the MAP has some benefits, overall it is arguably a flawed solution to the problem of international tax disagreement; a problem that is growing in size, scope and complexity each year owing to globalisation and the proliferation of tax laws (which seem to be equally inexorable forces). International tax arbitration has long been suggested, but only in recent years has it started to be implemented, in contrast to the established heritage of international dispute resolution in other areas of cross-border trade and investment.

Subject matter of international tax disputes

In terms both of frequency of cases and the amount of money at stake, the major international tax disputes have been over transfer pricing,[8] where a difference between what each tax authority, and the taxpayer, considers to be the arm's length price usually leads to a form of double taxation. Tax treaties grant states the authority to adjust transfer prices to accord with the arm's length standard.[9] Given the

[4] OECD Report, n 1, p 5. (Note that paras 1 to 4 of the Article set out the OECD's mutual agreement procedure as it currently stands, which is examined in Part 2 of this article).

[5] For example, for a discussion of the constitutional issues Japan faces in considering international tax arbitration, see Masui Y, "Treaty Arbitration from a Japanese Perspective" (2004) 58 *Bulletin for International Fiscal Documentation* 14, in which Masui concludes that "even if these difficulties are considered to be grave, the idea of treaty arbitration should not be abandoned altogether … even the use of mediation is a step forward compared with the status quo".

[6] OECD Report, n 1, pp 6-12.

[7] OECD Report, n 1, pp 12-17.

[8] McLure C, "Globalization, Tax Rules and National Sovereignty" (2001) 55 *Bulletin for International Fiscal Documentation* 328 at 337; Altman, n 4, Ch 2. For Australian figures see Part 2 and Appendix 1 below and Friezer M, "The Mutual Agreement Procedure in Australia" (1990) 7(1) *Australian Tax Forum* 63 at 65.

[9] See Art 9 of OECD Model Convention, n 2.

estimate that more than 60% of global trade takes place between related entities,[10] the scope for transfer pricing disputes is enormous. The term "transfer pricing" is used here in a wide sense, to include imputed interest in related party cross-border financing[11] and the allocation of business profits to a permanent establishment.[12]

However, there are many other tax questions that can be subject to disagreement between states, including whether an entity is resident in or has a permanent establishment in a state;[13] how an item of income is to be characterised[14] and where it is sourced; and how terms in tax treaties are to be interpreted.[15] Since the interpretation of tax law and the formulation of tax policy have traditionally been jealously guarded sovereign imperatives, opening up these decisions to arbitration may be too ambitious an aim for the international tax arbitration movement. Nonetheless, Maarten Ellis suggests that, even though double taxation was not threatened, the facts in the Australian case of *FCT v Lamesa Holdings BV*[16] may be an appropriate candidate for international tax arbitration.[17] *Lamesa* concerned whether Australia could impose tax, where the Netherlands did not, by interpreting the term "real property" in the Australia-Netherlands tax treaty to include shares in a company which held Australian mining licences through subsidiaries. However, the Dutch government's incentive to fight such an arbitration, beyond the representation of its resident and a general defence of its capital gains tax policy, could be queried. Arbitrations over competing tax policies might be awkward, to say the least, and, while they could foster dialogue about tax reform, they are unlikely to gain state approval at this stage.

The fact that international tax arbitration is not well known in practice means that it will probably evolve by gradual steps only. At present, there is greater experience in and agreement on the arbitration of transfer pricing disputes than there is with respect to the arbitration of non-transfer pricing international tax disputes, because the former tend to be more factual and are thought to impinge less on states' tax policies and jurisprudence. While it is therefore most likely that a body of tax arbitration practice will first emerge in the context of transfer pricing cases, this article discusses tax arbitration in a general way, to allow for application to a variety of international tax disputes.

The mutual agreement procedure

The proponents of international tax arbitration are usually identifiable as taxpayer groups,[18] tax professionals,[19] academics,[20] and international organisations,[21] and the starting point of their case is

[10] Neighbour J, "Transfer Pricing: Keeping it at Arm's Length" (2002) (Jan) *OECD Observer* 230.

[11] For example, see *WR Carpenter Holdings Pty Ltd v FCT* [2007] FCAFC 103 (interlocutory only).

[12] For example, the series of "NatWest" cases in the United States: *National Westminster Bank plc v United States* 44 Fed Cl 120 (1999); *National Westminster Bank plc v United States* 58 Fed Cl 491 (2003); *National Westminster Bank plc v United States* 69 Fed Cl 128 (2005).

[13] For example, *McDermott Industries (Aust) Pty Ltd v FCT* (2005) 59 ATR 358; 2005 ATC 4398; [2005] FCAFC 67.

[14] For example, the American case *Boulez v Commissioner* 83 TC 584 (1984) in which the United States characterised payments to the conductor Pierre Boulez as personal services income whereas Germany characterised them as royalties.

[15] Similar potential areas of disagreement are listed as covered by the MAP in Art 25 of the United States Model Tax Treaty and Art 24 of the Australia-United States Tax Treaty.

[16] *FCT v Lamesa Holdings BV* (1997) 36 ATR 586; 77 FCR 597; 97 ATC 4752.

[17] Ellis M, "Issues in the Implementation of the Arbitration of Disputes Arising Under Income Tax Treaties – Response to David Tillinghast" (2002) 56 *Bulletin for International Fiscal Documentation* 100 at 101.

[18] For example, United States National Foreign Trade Council, *Towards a US Tax Treaty Policy for the Future* (2005), http://www.nftc.org/default.asp?Mode=DirectoryDisplay&id=191 viewed July 2007; International Chamber of Commerce (ICC), Doc 180/455, Rev 2 (February 2002), http://www.iccwbo.org/policy/taxation/id501/index.html viewed April 2007; Ellis, n 17 at 100 reports that the private sector "cries for the application and implementation of the EU Arbitration Convention".

[19] For example, see Bell K, "Treaty Arbitration Finds Favor in UK, US" (2007) 45 *Tax Notes International* 631.

[20] For example, OECD Report, n 2; International Fiscal Association (IFA), *Resolution of Tax Treaty Conflicts by Arbitration*, Seminar (Florence, 1993) Vol 18e; Altman, n 3, summarises practitioner and academic scholarship in Ch 1, Pt 1.3.

[21] For example, notably and recently, the OECD.

usually what they see as the unsatisfactory nature of the MAP. The MAP is the way in which most international tax disputes are resolved (or not resolved) today, and for many countries it has been so for over 50 years. Essentially, the MAP is an informal negotiation between the tax authorities of the disputing states, provided for in general terms by the tax treaty between them. MAP provisions are usually based on the current Art 25 of the OECD model treaty, the substance of which is the following process:

1. A resident of one of the treaty states who considers that one or both of the states is attempting to tax it otherwise than in accordance with the treaty takes their case to the competent authority of their home state. "Competent authority" usually refers to the tax administration or treasury in a given country. The Australian competent authority currently is comprised of two Assistant Commissioners in the International Strategy and Operations division of the ATO.
2. Domestic remedies in either state that may be open to the taxpayer do not need to be pursued or exhausted by the taxpayer in order for them to approach their "home" competent authority.
3. The home competent authority tries to resolve the dispute directly with the taxpayer.
4. If this cannot be done, the home competent authority contacts the foreign competent authority directly and the two competent authorities attempt to resolve the dispute by mutual agreement with a view to avoiding taxation that is not in accordance with the treaty, which usually means avoiding double taxation.
5. The two competent authorities may also be able to liaise with each other to resolve any difficulties or doubts in the interpretation or application of the treaty generally, and to deal with cases of double taxation not covered by the treaty.

Australia's MAPs, as expressed in its tax treaties, mostly resemble the above, although the final point, the "gap-filling" power, has only been implemented in Australia's recently renegotiated or negotiated treaties. Taxation Ruling TR 2000/16 contains some more detailed information about Australia's MAP.

Strengths of the MAP

Although it is the shortcomings of the MAP that drive the tax arbitration movement, it is necessary to also mention the strengths of the MAP, because they are relevant to the author's conclusion on the desirability, on balance, of arbitration. In Australia and many other countries, MAPs are usually conducted with considerable flexibility and "goodwill".[22] They need not be expensive to the taxpayer involved, with the main direct costs being administrative and professional adviser fees. Institutional expertise can be another advantage: the competent authorities of many countries have long-established MAP experience – although this is a standard argument in favour of the status quo in any debate about institutional change. Lastly, it is clear that there are many international tax disputes which are resolved satisfactorily under the MAP, in the way that disputes generally are often resolved by some form of unstructured negotiation.

Australia's recent MAP experience

Australia's MAP seems to have a good reputation, as far as MAPs go.[23] The Commissioner of Taxation, Michael D'Ascenzo, said the following about the MAP at an address last year:

> Australia's MAP cases have generally involved fellow OECD member countries, with almost one-third of the 66 MAP cases finalised since 1999 being with the US. A further one-third of cases finalised in that time were with Japan and the balance were with European and Asian treaty partners. There have been four instances in the past ten years (out of a total of 83 MAP cases) where the Tax Office hasn't been able to achieve full relief from double taxation under MAP. These cases involved $4 million of unrelieved double taxation. To put this in perspective, the Tax Office has participated in agreements resolving more than $150 million of double tax in the past three years.[24]

[22] Altman, n 3, p 254. The French language version of the OECD Model Convention, n 2, refers to the MAP as the "Procédure Amiable", usually translated into English as the "friendly procedure".

[23] Based on discussions with advisers, the ATO, and reports such as Ernst & Young, *2005-2006 Global Transfer Pricing Survey* (2006), http://www.ey.com/global/content.nsf/International/Transfer_Pricing_Global_Survey_2005-2006 viewed July 2007, pp 30, 35.

[24] D'Ascenzo M, Address to the American Chamber of Commerce (Four Seasons Hotel, Sydney, 26 September 2006).

The author's research into Australia's recent MAP practice (see Appendix 1 for data tables) has confirmed that almost all cases submitted to Australia's MAP have been resolved, with double taxation being eliminated. However, this is not the full story. First, the elimination of double taxation does not guarantee a just outcome. For example, in a transfer pricing case, the competent authorities may agree on an arm's length price which suits them both but deviates substantially from the correct arm's length price; as a result of tax rate differentials the taxpayer may pay more tax overall than if the correct arm's length price was used, despite there being no double taxation.

The length of time a case takes to reach resolution can be just as important as whether a given MAP case is resolved or not. A substantial number, although not the majority, of disputes submitted to Australia's MAP are resolved within two years, and many of the taxpayers involved in these MAPs would presumably have been satisfied with the process. However, from 1999 to 2006, 53% of transfer pricing cases resolved in MAP took more than two years to do so. The statistics obtained end at 1 July 2006, when the ATO had 12 transfer pricing MAPs in progress. According to a transfer pricing adviser, only one transfer pricing case was resolved in the six months to 31 December 2006, at which point there were 19 transfer pricing MAPs on hand, some of which had been in train for several years. The data and anecdote both suggest an undulating pattern of cases on hand relative to resolved cases, which may reflect clumps of cases getting "stuck" in the system alternating with periods of freed-up resources which are available to resolve cases quickly.

For non-transfer pricing MAPs, the average case length is longer than that of transfer pricing MAPs. This is said to be because these cases involve the positions that countries take on treaty law and tax policy, some of which are presumably firmly held, and are therefore more difficult to settle than the transfer pricing cases, which involve factual material and numerical apportionment. As it is, over the last five years, the ATO has been involved in 19 non-transfer pricing MAPs, of which 11 have been completed, six are still on hand, one was rejected and one withdrawn. Eighty two per cent of these MAPs took or are taking more than two years to complete.

Various other statements about Australia's MAP can be made. Combined with an earlier set of data,[25] the author's research indicates that there has been a trend for the number of cases submitted to MAP each year to increase: from 1984 to 1989, there was an average of four new MAPs per year; from 1990 to 1999, the average was five; and from 2000 to 2006, it was 10. Roughly half of the MAPs were initiated by the foreign treaty partner and half by Australia. In 2006, the dollar amounts in dispute in the transfer pricing MAPs ranged from $300,000 to $180 million, according to the ATO.

The data in Appendix 1 does not cover bilateral advance pricing agreements (APAs) conducted by mutual agreement between the ATO and other competent authorities. Bilateral APAs are an example of how the MAP can be a practical and appropriate way to come to agreement about transfer pricing, and the moves to encourage bilateral APAs are to be commended.[26] However, this article considers arbitration as an alternative to the MAP for ex-post disputes, to which bilateral APAs are not relevant (except where the dispute is over how an APA is to be applied or interpreted). Further, discussions with advisers identified that tax authority reasoning and decisions can be inconsistent between a bilateral APA which applies to a taxpayer's future transactions, on the one hand, and a MAP with respect to similar transactions which that taxpayer conducted in the past, on the other hand, even if both are negotiated at the same time between the same parties. An adviser suggested that this disconnect is a result of the MAP being less developed and less transparent than the bilateral APA process.

Something that, by its nature, the data casts no light on is those cases which are not submitted to the MAP at all, despite being appropriate candidates, perhaps because the taxpayer suspects that the MAP will not be a satisfactory dispute resolution process. This sort of "case gap" has been identified with respect to other jurisdictions (discussed further below) and by Mark Friezer in 1990 with respect to Australia. While MAP usage in Australia is greater now than it was in 1990, comparing it with the

[25] Friezer, n 8.

[26] See ATO, *Advance Pricing Arrangement Program 2005-06*, Update, http://www.ato.gov.au/large/content.asp?doc=/content/80179.htm viewed July 2007; Ernst & Young Survey, n 23.

variables used by Friezer – MAP usage rates in the United States[27] and the frequency of ATO transfer pricing audits[28] – it is possible that the MAP is under-utilised in Australia today, in that some taxpayers choose to accept double taxation, or litigate or settle with the ATO, rather than commence MAP.

Further, even if Australia's MAP is satisfactory, that is only half of the picture as far as inbound or outbound Australian taxpayers are concerned. The average length and rate of resolution of MAPs in some other jurisdictions is longer and lower, respectively, than in Australia.[29] An adviser to taxpayers involved in Australian MAPs said that while the ATO usually welcomes some taxpayer participation in the MAP and is not obstructive, certain tax authorities on the other side of the MAP are not always so helpful or inclusive.[30]

Shortcomings of the MAP

Moving away from the Australian experience to examine the very nature of the MAP, it can be observed that the MAP has problems, some of which are inherent in its strengths. Furthermore, the strengths identified, such as flexibility, amicability and expertise, are not observable in all MAPs.

The usual complaints about the MAP are that it contains no promise of resolution, is long, inefficient and opaque, and is biased in favour of tax authorities. As Friezer observed, "It seems the procedure suffers rather a bad 'press'".[31] If the MAP is under-utilised because of these complaints, as some commentators suggest, then that is also a problem of itself. The option to arbitrate is intended to ameliorate some of the problems of the MAP, and, somewhat paradoxically, to encourage the better use and further development of the MAP.

Arguably, the biggest problem with the MAP as a dispute resolution institution is that it contains no obligation for competent authorities to resolve a dispute, just (in the words of the OECD model MAP provision) to "endeavour to" do so. For taxpayers who seek certainty that their cross-border economic activities will not ultimately result in double taxation, this aspect of the MAP is particularly troubling and could discourage investment and trade. It must be borne in mind that failing to agree is, at least in theory, a very real possibility in a MAP, as the competent authorities in any given dispute are likely to be at loggerheads, with one state's fiscal gain being the other's fiscal loss. When a high-stakes MAP fails, it causes ill will all round. For example, several advisers interviewed by the author averted to the recent failure of the MAP between the United States and the United Kingdom regarding GlaxoSmithKline's transfer pricing (Glaxo eventually settled with the United States for $3.4 billion)[32] in a way that suggested it has tarnished the reputation of the MAP as an institution.

MAPs that last for several years have their own particular problems. The dispute can become more and more entrenched as time passes.[33] Logistical problems also arise, such as the re-tracing of

[27] Altman, n 3, Pt 2.5.

[28] The ATO's annual Compliance Program publications, available on the ATO website, provide the number of transfer pricing audits and risk-assessments planned for that year. In the three years to 2005-06, the projected number of large business transfer pricing audits is two, seven and eight times more than the number of MAPs commenced that year, respectively, and the MAP figures are entirely dwarfed if the large business audit numbers are combined with those for small to medium businesses and the numbers of transfer pricing risk assessments conducted. However, this discrepancy could be attributable to factors other than disinclination to commence MAP.

[29] For example, Altman, n 3, pp 135-144 reports statistics indicating that only 29% of intra-European transfer pricing disputes submitted to MAP in 1995 were successfully resolved by 1997, and by 2000 the figure was still only at 77%. See also Morgan J, "New Developments in the Resolution of International Tax Disputes" (2007) 43 *Tax Notes International* 77 at fn 10.

[30] This occurrence is also suggested in ATO, *Income Tax: International Transfer Pricing Transfer Pricing and Profit Reallocation Adjustments, Relief from Double Taxation and the Mutual Agreement Procedure*, Taxation Ruling TR 2000/16 (2000) at [4.24].

[31] Friezer, n 8, p 78.

[32] Matthews G and Whalen J, "Glaxo to Settle Tax Dispute With IRS Over US Unit for $3.4 Billion", *Wall Street Journal* (12 September 2006).

[33] Altman, n 3, p 142 speculates on the basis of the statistics he gathered that "the longer a case is open the less likely it will result in a successful conclusion".

steps required when personnel experienced in the case depart the taxpayer organisation or the competent authority, which will be lengthy and involved where the facts are as complex as they often are in transfer pricing cases.

The informality of the MAP and the collegial relationships between certain competent authorities means that the MAP is susceptible to being or being seen to be[34] lacking in transparency. Until recently, the publication of guides to MAP policies and procedures was rare.[35] MAP decisions and reasons are usually kept confidential, and while confidentiality encourages specific taxpayers to take the plunge into a MAP, the absence of published outcomes can lead to the general mass of taxpayers being wary or even unaware of the MAP. This tension is discussed with respect to arbitration in Part 3 below.

There is a suspicion on the part of taxpayers that competent authorities engage in horse-trading[36] and, to mix the animal metaphors, "[t]here is always a fear of being a sacrificial lamb when two competent authorities have several cases to be resolved at the same time", writes David Tillinghast.[37] While horse-trading could allow for quicker resolution and will sometimes be something that the taxpayer is indifferent to, it is not sustainable because it hinders the development of principled reasoning and can lead to taxpayers lacking confidence in the justice of outcomes.

The MAP could be seen by taxpayers as too much a creature of the competent authorities. The competent authority is gatekeeper, prosecutor and judge: it decides whether to contact the other competent authority, and, together with that other competent authority, presides over the proceedings and decides on the outcome. Taxpayers often have limited involvement in a MAP, other than providing information. Discussions with advisers revealed that some taxpayers feel that competent authorities abuse their position of power in a MAP by turning it into what seems like a "joint audit", using the promise of resolution as leverage to obtain more and more information from the taxpayer.

Further anecdotal information about Australia's MAP indicates that sometimes the barrier to resolution is a reluctance on the part of one competent authority to create a "precedent", eg to allow a certain transfer pricing methodology to be applied to a type of transaction that the authority usually does not allow it to be applied to. Even though MAPs do not create formal precedent and are supposed to be confidential, it would seem that the taxpayer and adviser grapevines are effective enough for some tax authorities to be concerned about floodgates opening. Arbitration may ease this barrier to agreement, as it is the arbitral panel that makes the decision; the competent authority can wash its hands of it, to a degree.

The length and inefficiency of a MAP seems to be a function of the bureaucratic exigencies of the states involved rather than anything intrinsic in the MAP process. If anything, the informality, flexibility and confidentiality of the MAP may allow it to be a quicker process than, say, litigation. Arbitration along the lines of the OECD model is not necessarily a solution to the slowness of the MAP, since it takes place within the MAP and is probably subject to the same bureaucratic overlays, but at least arbitration provides a finite time limit for an unresolved MAP (two years in the case of the OECD model), and encourages resolution within that limit.

The MAP strengths of flexibility and goodwill are not observable uniformly across the board. Many competent authorities are not given enough discretion by the state to allow for flexibility, and

[34] In the absence of procedural transparency, the "losing" side in a dispute will usually feel more dissatisfied and aggrieved than they would have were the process transparent.

[35] The ATO has provided some guidance in ATO, Taxation Ruling TR 2000/16, n 30 and ATO, *Referral of Work to International Strategy and Operations*, Practice Statement Law Administration PSLA 2006/9 (2006). See also the MAP Operational Guidance for Member Countries of the Pacific Association of Tax Administrators (PATA) (the member countries are Australia, Canada, Japan and the United States). The United States has published relevant revenue procedures such as Internal Revenue Service, Revenue Procedure 2006-54 (2006). See Morgan, n 29, for the limited guidance that China has published.

[36] Züger M, *Arbitration under Tax Treaties: Improving Legal Protection in International Tax Law* (Amsterdam, IBFD Doctoral Series, 2001) p 15.

[37] Tillinghast D, "Issues in the Implementation of the Arbitration of Disputes Arising Under Income Tax Treaties" (2002) 56 *Bulletin for International Fiscal Documentation* 90 at 91.

friendly camaraderie does not characterise all competent authority relationships. In fact, political enmities independent of tax could creep into a given MAP due to the fact that it is internal, bureaucratic and not rules-based. At any rate, countries with legitimate differences in tax policy and administrative style, not to mention language and culture, may be short-changed by a MAP process which assumes that anything can be resolved by just talking it through. As the patterns of trading relationships change with ever-expanding globalisation, eg with the increasing trade between developed Western countries and China and India, it can be predicted that the MAP as we know it will become less and less satisfactory.[38]

Whatever the strengths and weaknesses of the MAP, it is observable that it is under-utilised in some countries.[39] Taxpayers may be deterred by a perception that a MAP would take too long, may not resolve the dispute at all and may be conducted without sufficient involvement on their part. Friezer speculates that it may be "an anathema for taxpayers to place reliance on tax authorities to obtain relief from taxation".[40] There are other explanations for under-utilisation, such as a desire on the part of taxpayers to avoid re-opening assessments in one or both jurisdictions. Certainly, it seems that the MAP is rarely resorted to where the amounts in dispute are relatively small, eg where the taxpayer is an individual, although the amount may be significant to them; operationally, most competent authorities are situated within a large business division of the tax authority, reflecting the transfer pricing orientation of most MAP practice. Under-utilisation reflects problems in the MAP and creates problems of its own: MAP expertise can atrophy, as can taxpayer faith in the process itself. The option of arbitration is likely to encourage greater use of the MAP, although not in all circumstances.[41]

The OECD has recently developed an online Manual for Effective Mutual Agreement Proceedings (MEMAP) as part of a wider project to improve the effectiveness of MAPs,[42] which may go some way towards fixing the shortcomings mentioned above; however, many of them are inherent in the MAP's nature as an informal process presided over by the competent authorities.

International tax arbitration

The primary strengths of arbitration, as an international tax disputes mechanism, are independence, the promise of finality, and transparency to the taxpayer.

The idea of international tax arbitration has a long history. European proposals for an international tax tribunal date back to the late 19th century.[43] The 1927 League of Nations draft tax convention envisaged final resolution of tax disputes by an expert body or an international court.[44] The idea was periodically revived throughout the 20th century.[45] However, despite institutional change in comparable arenas, no international tax arbitral institution, bilateral or multilateral, came about until relatively recently.

It is understandable that an association between international tax disputes and arbitration would be drawn. Arbitration has long been the preferred dispute resolution process under many international agreements with economic subject matter, such as bilateral investment treaties (BITs), the North American Free Trade Agreement (NAFTA) and contracts governed by the Vienna Convention on the International Sale of Goods. Such arbitrations are often between a private entity of one state and the government of another, just as international tax disputes often are, in essence, despite the convention of state-to-state MAPs. Further, the creation in 1994 of a permanent, multilateral and legalistic dispute

[38] Morgan, n 29.

[39] Friezer, n 8, pp 76-77; Altman, n 3, pp 184-86; OECD Report, n 1, p 4.

[40] Friezer, n 8, p 79.

[41] For example, individuals may find arbitration no more, and perhaps less, accessible than the MAP.

[42] MEMAP and other information on the MAP project is available at OECD website, http://www.oecd.org viewed July 2007.

[43] Altman, n 3, p 75.

[44] Vogel K, *Klaus Vogel on Double Taxation Conventions* (3rd ed, Kluwer, 1997) p 1347.

[45] Vogel, n 44, pp 1347-1348; Altman, n 3, Ch 1, Pt 1.3.

settlement body within the World Trade Organisation served to further emphasise the schism between the resolution of international trade disputes and that of international tax disputes. Although the institutions and instruments of international tax, trade and investment differ from each other in significant ways, they generally share the underlying objective of encouraging cross-border economic activity, and there have been several notable overlaps between these disciplines,[46] so comparison is appropriate.

Despite this background, it was not until the signing of the 1989 United States-Germany tax treaty that the first specific tax arbitration provision was embodied in any treaty. That provision was a more succinct variant of the OECD proposal excerpted above, although its operation was circumscribed by placing issues of domestic tax law or tax policy out of bounds and requiring the consent of both states to arbitrate. In June 2006, Germany and the United States renegotiated their treaty and the arbitration provision is likely to become mandatory (ie only one competent authority and the taxpayer have to agree to arbitration) and to apply not only to transfer pricing disputes, but also to disputes over residence, permanent establishment, business profits and royalties. Since 1989, over 50 other tax treaties, mostly involving the United States, Germany, the Netherlands or Canada, have incorporated an arbitration provision. No tax treaty with Australia has an arbitration provision as yet.

In the extensive research for his 2005 book, Zvi Altman did not uncover evidence of any arbitrations having taken place under the bilateral tax treaties that have arbitration provisions.[47] The author's research indicates that this does not seem to have changed since 2005. However, arbitration can act as a looming spectre which encourages satisfactory settlements and mutual agreements. There is suggestion this has successfully occurred since the introduction of certain arbitration provisions.[48] One treaty under which tax arbitrations have taken place, however, is Europe's transfer pricing convention.

In 1990, the Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises (EC Arbitration Convention) was signed by the 12 then members of the European Union. It provides for mandatory referral to an Advisory Commission of disputes over transfer pricing which cannot be resolved after two years of a mutual agreement process. The Advisory Commission is effectively an arbitral tribunal, comprised of a representative of each competent authority involved in the dispute as well as a group of independent commissioners appointed by mutual agreement. A convention to extend the EC Arbitration Convention to the 10 states that joined the European Union in 2004 is in the course of ratification.[49]

As at 2005, three disputes had been referred to arbitration under the EC Arbitration Convention, all by France.[50] No further data on these arbitrations have been published, but anecdotes about the first, an arbitration between France and Italy regarding Electrolux affiliates which was resolved in 2003, indicate that, like many firsts, it was unwieldy. It reportedly took 18 months to select the arbitral panel – potential arbitrators seemed to have baulked at the volume of required reading – and issues of

[46] For example, United States – Tax Treatment for *Foreign Sales Corporations*, AB-1999-9, Report of the Appellate Body, WT/DS108/AB/R; Art 22(3) of the General Agreement to Trade in Services (GATS) Treaty. Altman, n 3, pp 346-347 mentions BIT arbitrations that involved taxation. Pijl H, "State Responsibility in Tax Matters" (2006) 60 *Bulletin for International Fiscal Documentation* 38 at 51 notes several arbitral institutions which at least theoretically have competence in tax matters. Generally, see Avi-Yonah R and Slemrod J, "Should Trade Agreements Deal with Income Tax Issues" (2002) 55 *Tax Law Review* 533; Green R, "Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes" (1998) 23 *Yale Journal of International Law* 79.

[47] Altman, n 3, p 346.

[48] Bell K, "Treasury Official Addresses Sovereignty Concerns Raised by Germany-US Treaty Protocol" (2006) 112 *Tax Notes* 240; Turner G, "Canada-US Competent Authority MOU: First Steps to Mandatory Arbitration?" (2005) 39 *Tax Notes International* 1223 at 1232; Ellis, n 17 at 100.

[49] Gnaedinger C, "18 Member States Ratify EU Arbitration Convention" (2007) 46 *Tax Notes International* 149.

[50] Altman, n 3, pp 137-138.

costs, logistics and travel seemed to have dominated the procedure.[51] However, the arbitral award, as yet unpublished, is reported to have alleviated double taxation.[52]

PART 3: KEY ISSUES

As an institution, international tax arbitration is very much in its infancy. It seems likely to fix some problems of the MAP, but not all, particularly while it resides within the MAP. In addition, arbitration in the form presently proposed by the OECD is by no means the perfect international tax dispute resolution institution. For example, the reach of its net, even if the OECD's proposal proves popular, will be far from universal in terms of the countries that can and do adopt the provision and the sorts of disputes that will be covered. However, as concluded below, international tax arbitration even in a limited form is a good thing. Further, apart from being good or bad, the development of international tax arbitration may be inevitable, perhaps as a step on the way to another paradigm.[53]

Arbitration is a substantial area of law of itself, whereas the OECD's new model paragraph is just a few lines long. The paragraph ends with the note that "[t]he competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph". This requires each country wishing to implement the recommendation to consider specifics of the form and scope of arbitrations. The OECD envisages that each pair of treaty states that implement a variant of the new paragraph will draft an arbitration agreement, to be published along with the treaty.[54] This section examines some decisions about the important features of international tax arbitration that countries will face in implementing the OECD's recommendation.

Standing and participation

According to the OECD model, once a MAP has run for two years without mutual agreement as to relief of double taxation, a taxpayer may (but does not have to) call for arbitration. The states involved are then obliged to arbitrate. They also commit to being bound by the outcome of the arbitration, unless that outcome is rejected by the taxpayer. A variation on this structure would remove the mandate for states to arbitrate and instead require their consent to arbitrate any given dispute which has not been resolved after two years of MAP. This is not ideal, but could be a good pragmatic transitional provision to let states get comfortable with the idea of arbitration.

Although the taxpayer initiates the arbitration, it is not a party to the arbitration under the OECD model, or any other existing tax treaty. A primary benefit of increased participation would be an improvement in taxpayer perception – and therefore uptake – of international tax dispute resolution mechanisms. On the other hand, since states tend to see arbitration per se as a usurpation of their sovereignty, they may reject arbitration entirely if they suspect it will be run by the taxpayer. A middle ground can probably be settled upon. Certainly, since arbitration of its nature is more structured and transparent (to the taxpayer) than the MAP, the taxpayer will probably be afforded a better opportunity to state and defend its case. It seems that the idea of having taxpayers, rather than the just the states concerned, as parties to arbitration is too ambitious at this stage, although there is precedent for private party-to-state arbitration under BITs and NAFTA. Note that the taxpayer may be a de facto party by aligning itself with one of the states, a likely occurrence under the "baseball" arbitration format which is discussed below.

[51] Turner, n 48; Bernath A, *The Implications of the Arbitration Convention* (Masters Thesis, Jönköping University, 2006), http://www.diva-portal.org/hj/abstract.xsql?dbid=548 viewed July 2007, Pt .1.

[52] Bernath, n 51.

[53] Such as the international tax court suggested by Lindencrona G and Mattson N, *Arbitration in Taxation* (Kluwer, 1981) or the multilateral treaty suggested by Avi-Yonah and Slemrod, n 46, or the Global Tax Organisation and Permanent International Tax Tribunal suggested by Altman, n 3, Ch 7.

[54] OECD Report, n 1, pp 11-25.

The arbitral panel

Many forms of arbitral panel are possible, from a single arbitrator, as in the "streamlined arbitration" option in the OECD model,[55] to a large advisory committee, as in the EC Arbitration Convention. A familiar process for compiling a panel in an arbitration between the governments or residents of two different states is that the two sides select an arbitrator each, with the third arbitrator being selected by those first two arbitrators and acting as chairperson. The standard panel envisaged in OECD sample arbitration agreement is structured in this way and provides that, failing selection by the first and second arbitrators, the third arbitrator shall be nominated by the Director of the OECD's Centre for Tax Policy and Administration (CTPA).[56] It is possible that in practice the OECD CTPA or another institution[57] will keep a register of qualified international tax arbitrators from whose ranks arbitrators will be drawn.

The selection of arbitrators raises several issues. One is whether representatives of the relevant competent authorities should be eligible for selection. Their potential vested interest in the outcome must be weighed against their expertise. In relation to transfer pricing disputes, competent authority representatives may be the only people with access to confidential data on comparables,[58] plus the experts in the private sector may all be employed either by the taxpayer or by one of its competitors. Both the United States-Germany treaty and the EC Arbitration Convention reserve key roles for competent authority representatives in arbitration; this, as well as the size of the panel envisaged in the latter, is criticised by Tillinghast.[59] The hearing of tax disputes by arbitrators who are experts yet independent of the tax authorities is one of the major advantages of arbitration over the MAP, so long as such arbitrators can be found and are willing. Other than tax officials and industry insiders, the third pool of potential arbitrators comprises tax and economics academics and professionals, including those who have retired. Ellis suggests that the ideal arbitrator would be an experienced, respected tax lawyer with a "true addiction to international tax issues".[60]

Terms of reference and procedure

Under the OECD model, the taxpayer can only initiate arbitration if there are "unresolved issues from the case" as between the two competent authorities which result in taxation not in accordance with the treaty; it cannot use arbitration to re-hear the dispute if it is simply unhappy with the MAP resolution.

The substantive content of the arbitration needs to be articulated in one or more questions for resolution. The OECD sample agreement calls these the Terms of Reference.[61] These may encompass the entire dispute, or just a part or parts. Examples are: What is the arm's length price? Does X have a permanent establishment in Country Y? The OECD envisages arbitrations taking place within the MAP so that the outcome of the arbitration is implemented by requiring the competent authorities to arrive at their mutual agreement, taking as a given the answer provided by the arbitral panel. The Commentary points out:

> under the paragraph, the resolution of the *case* continues to be reached through the mutual agreement procedure, whilst the resolution of a particular *issue* which is preventing agreement in the case is handled through an arbitration process.[62]

Although it may reside within the MAP, arbitration fundamentally changes the MAP because it requires an outcome and binds the states to that outcome as long as the taxpayer wishes them to be so

[55] OECD Report, n 1, p 14.

[56] OECD Report, n 1, pp 13-14.

[57] Tillinghast, n 37 at 98 considers institutions such as the ICC, the International Centre for the Settlement of Investment Disputes and IFA.

[58] Ellis, n 17 at 101; however, it may be possible to confidentially provide such data to arbitral panels.

[59] Tillinghast, n 37 at 97.

[60] Ellis, n 17 at 101.

[61] OECD Report, n 1, p 13.

[62] OECD Report, n 1, p 7 (emphasis in original).

bound. A possible variant is to allow the two states to disregard the arbitral outcome if they can arrive at another solution agreeable to both states and the taxpayer.[63] However, this may detract from the independence and efficiency benefits of arbitration and instil unnecessary doubt in the arbitral panel.

For disputes without a binary (yes/no) outcome, such as those over transfer pricing, it has to be decided whether the arbitral tribunal will draft its own outcome or will have to select one of two outcomes proposed by each state respectively. The former is referred to as the "independent opinion" format and the latter the "last best offer" or "baseball"[64] format. The OECD model arbitration agreement takes the independent opinion format;[65] the United States prefers the baseball format. The baseball format is said to allay concerns about a derogation from state sovereignty[66] because its outcome is the product of a state, although the flipside is that the *other* state's "sovereignty" has been usurped, if sovereignty is so conceptualised. One strength of the baseball format is that it encourages states to modify their more extreme positions to make them more palatable to the arbitral tribunal.

A practical consequence of the baseball model will be that the taxpayer will usually align itself with one of the competent authorities (the one under whose proposed outcome the taxpayer pays the least tax overall), whereas if the outcome is to be the independent opinion of the tribunal, the tribunal may be pulled in three ways. Although this distinction seems subtle, it could have significant consequences for the way that arbitrations play out in reality.

As for the rules of evidence and procedure which are to govern the arbitration, these could be adapted from a pre-existing arbitral institution, or new ones could be drafted. Under the OECD model arbitration agreement, the arbitrators are free to determine the relevant rules of evidence and procedure, but some uniformity would seem desirable.

Relationship with domestic litigation

Another issue in the design of an international tax arbitration system is the interface with domestic legal remedies. The relationship is considered here in three different stages: before arbitration, during arbitration, and after arbitration.

If a taxpayer has obtained a court ruling on the issue in dispute, this will usually preclude an arbitration taking place on that issue. Since in most countries, including Australia,[67] the tax administration cannot apply the tax law in a way contrary to its exposition by the judiciary, the OECD has included in its model paragraph the proviso that: "[t]hese unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State."

A corollary of this condition is that a taxpayer seeking arbitration need not exhaust all domestic legal avenues first. If they did and were satisfied, the need for arbitration would not arise, and if they did and were not satisfied, they would not, as a matter of constitutional or public law, be able to ask the competent authorities to effectively overturn the court's orders.

It is obviously not ideal to have arbitration and domestic litigation running in parallel on the same issue. In terms of the current MAP framework, taxpayers are usually required to not commence litigation, or to stay any litigation that has already commenced, while the MAP proceeds.[68] Presumably this condition would be imposed on most international tax arbitrations too, as suggested

[63] This is allowed in the EC Arbitration Convention and is noted in the OECD Report, n 1, p 11.

[64] The "baseball" metaphor is not derived from anything that happens on a baseball field, but is a reference to the way that labour law disputes in the United States Major League are resolved – see Bell, n 48.

[65] OECD Report, n 1, pp 16-17.

[66] Bell, n 48.

[67] For a recent example, see *FCT v Indooroopilly Children Services (Qld) Pty Ltd* (2007) 65 ATR 369 at [3]-[7] (Allsop J), [41]-[48] (Edmonds J); [2007] FCAFC 16.

[68] OECD Report, n 1, pp 9-12. In Australia, the ATO will accept an objection concurrent with a MAP request, but usually suspends the former, with the taxpayer's permission, while the latter proceeds, according to Taxation Ruling TR 2000/16, n 30, and discussions with ATO officers.

by the new Commentary to the OECD model.[69] Another question is whether a taxpayer can terminate the arbitration in order to pursue domestic litigation, or whether the arbitration must be allowed to run its course – during which time the taxpayer is precluded from litigating – until either an arbitral outcome is arrived at, or a period of time (eg six months) has expired. Allowing the taxpayer to revoke its request for arbitration may not have benefits that justify the insecurity it may instil in the arbitral process.

In terms of litigating after an arbitration, one course is to let the taxpayer choose at the time of the arbitral outcome to either be bound by it (and waive its rights to domestic litigation) or to disregard the outcome (and therefore be free to litigate). Providing this choice is the OECD's preferred course at present,[70] and is also the approach of the EC Arbitration Convention. Alternatively, a taxpayer could waive its rights to domestic remedies at the time of initiating arbitration, subject to safeguards ensuring that, procedurally, there will be fairness[71] and that, substantively, double taxation will in fact be relieved.[72] Tillinghast prefers the latter course, reasoning that it is consistent with the purpose of international tax arbitration, being:

> to permit the affected parties to avoid costly and often duplicative administrative proceedings and litigation in the two countries involved, with the inherent risk that the results achieved in one country will be inconsistent with the results achieved in the other.[73]

Even after an arbitral award is made, sovereign immunity doctrines may limit its ability to bind a state, plus it is uncertain whether the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards would at present apply to international tax arbitrations.[74] At the very least, these issues could be addressed in bilateral negotiations.

Confidentiality and precedent

Across different areas of law, one reason why parties opt for arbitration over litigation is that the content and outcomes of arbitrations are usually secret. In the tax and transfer pricing context, taxpayers tend to prioritise secrecy when it comes to both their tax affairs and the pricing of their goods and services. Synthesising these facts, the prospects for developing a stable of international tax arbitration precedents do not look good. An additional problem in the transfer pricing area is that sanitising a transfer pricing arbitral decision could denude it entirely of content if the taxpayer's sensitive trade and pricing information comprises the meat of the case.

Nonetheless, some efforts could be made by the OECD or another institution to collate sanitised information such as the principles used by panels to arrive at decisions. Of course, even a patchy collection of international arbitration precedents would be an improvement on the MAP status quo, under which very little beyond statistics is published.

Discussion of precedent touches on an important issue for international tax arbitration: whether arbitrations should be resolved in a pragmatic, case-specific manner, or in a more "legalistic" manner involving reference to precedent. Altman reports the view of United States tax officials that fidelity to precedent would make international tax disputes more and more difficult to resolve into the future.[75] On the other hand, one of the advantages of a co-ordinated framework for the resolution of certain types of disputes (and the OECD's arbitration recommendation is co-ordinated to a certain extent) is that different approaches and ideas can be shared, with the best ideas disseminated as quickly as possible so "the cream rises to the top". However, one of the ways in which arbitration is

[69] OECD Report, n 1, pp 9-10.

[70] OECD Report, n 1, p 10.

[71] Tillinghast, n 37, p 93

[72] OECD Report, n 1, pp 10-11.

[73] Tillinghast, n 37, p 93.

[74] Altman, n 3, p 320.

[75] Altman, n 3, p 329.

distinguished from litigation is that, of its nature, it is less reliant on precedent.[76] Further, in the short to medium term, any arbitrations that emerge are likely to be fact-intensive arbitrations over transfer pricing which will probably benefit less from precedents than would more legalistic arbitrations.

Waiver of MAP

As international tax arbitration increases in profile, taxpayers may want the option of going directly to arbitration when a dispute crystallises because this may avert two years of a fruitless MAP. Of course, the argument against this is that keeping the MAP mandatory strengthens its effectiveness, maximising the chance that the dispute will not need arbitration. It is probably fair to say that some disputes are best resolved by a MAP and others by arbitration according to the nature of the dispute or the idiosyncrasies of the MAP or arbitration concerned. However, while international tax arbitration is such a young institution, there is not yet a case for allowing the latter type of dispute to bypass the MAP that is strong enough to depose the proposition that, for practical purposes at least, arbitrations should take place within the MAP. This is particularly so if the MAP is to be improved through the OECD's MEMAP and other projects.

PART 4: CONCLUSION AND IMPLICATIONS FOR AUSTRALIA

Like most commentators today, the author's position on international tax arbitration is one of cautious approval. The approval is based on its obvious strengths: finality, independence and transparency to the parties, and its strong "spectral" role in forcing MAPs to resolve more quickly. The caution comes from the warnings of commentators and tax authorities that it is a "great unknown".

International tax arbitration is best adopted incrementally, starting with transfer pricing disputes, and beginning with an attempted MAP each time. Given this modest vision, the author ventures to suggest that international tax arbitration is not such a great unknown after all. It is true that there is little experience as yet; however, competent authorities and certain taxpayers and advisers know what MAPs are like. They also know the nature of fact-intensive transfer pricing negotiations such as APAs and ex-post settlements. There is institutional knowledge about how arbitrations proceed under BITs, the NAFTA and other treaties. To some degree, international tax arbitration will be a matter of putting these pieces together, although it does not necessarily follow that such a process will be simple or without incident.

This article does not herald arbitration as an ideal mechanism, nor as a replacement for the MAP or litigation. For example, while restricting arbitration to transfer pricing cases is a good practical starting point, such cases highlight a major shortcoming of arbitration: the difficulty of generating consistently useful precedents for wide dissemination (the flipside of its attractive confidentiality). Further, while it is also appropriate at this stage for arbitration to take place only after a MAP has been attempted, this too derogates from a potential benefit of arbitration, being increased efficiency and independence in dispute resolution. Ultimately, it is likely that different forms of international tax dispute resolution will continue to evolve to suit different disputes and circumstances. Therefore, it will be a good thing for taxpayers to have access to arbitration if it suits their disputes and circumstances.

Australian government perspective

None of Australia's tax treaties have arbitration clauses as yet, and neither the ATO nor the Treasury has announced Australia's position on the OECD's recommendation. The author's conversation with a representative of the ATO indicated that the ATO views international tax arbitration as a predominantly European notion at present, and that the ATO's sole stipulation of the OECD project was that the arbitration provision in the model treaty be optional.[77] It was also stated that the ATO would take issue with any arbitration provision that, in its coverage, would go beyond transfer pricing. While this caution is sensible, it could overlay an institutional aversion to arbitration, given that, to most competent authorities, the MAP status quo is a happy one, in terms of control and familiarity.

[76] Altman, n 3, p 328.

[77] The footnote to the new paragraph assures it is – see Part 1 above.

The Treasury's position on international tax arbitration, according to a Treasury representative, is that it seems viable in theory and, while the Treasury is open to the idea of arbitration clauses in Australia's tax treaties, it is presently considering whether any are necessary. It has given no indication that any of the treaty negotiations Australia is scheduled to undertake in the near term will involve debate over arbitration clauses.

However, the OECD's announcement seems to have stimulated comment from other states: a week after the announcement, the head of the United Kingdom Revenue and Customs tax treaty team told *Tax Analysts* that the United Kingdom is in favour of tax treaty arbitration,[78] and in March 2007 the United States head tax treaty negotiator told the *International Tax Review* that "we will continue to propose an arbitration provision in the mutual agreement procedure when we negotiate with other countries", and that she does not see any downside to an arbitration provision as part of the MAP.[79] Once a critical mass of influential states advocate arbitration clauses, the uptake should gather momentum because few states want to be the contrarian who appears to be trying to shield its competent authority from review.

Australia could take a gradual approach to the adoption of arbitration provisions, negotiating them first with countries with whom Australia has a good competent authority relationship before engaging with countries with "aggressive" international fiscal positions.[80] One imagines that the insertion of an arbitration provision into a given treaty could come down to the dynamics and public relations of the negotiation itself. For example, consider a mandatory arbitration provision being inserted as the "icing on the cake" of a "successful" treaty which also reduces withholding rates. An arbitration provision is a digestible sound bite that can help the treaty win headlines and handshakes.

While the adoption by the ATO and the Treasury of a "wait and see" approach is understandable, in the author's view, the Australian government should actively engage with international tax arbitration rather than thinking that a good MAP record will always suffice. Even a flawless MAP is still only a MAP, and it is arguable that as Australia's economy becomes ever more complex and globalised, it will start to look unsophisticated and inappropriate for the MAP to be the sole cross-border tax dispute resolution mechanism. Further, even if the ATO is one of the more efficient tax administrations in the world, that is only half the story when it comes to considering a tax arbitration provision in a bilateral treaty. One way that the ATO and the Treasury could actively engage is by publicly consulting on the topic with inbound and outbound Australian taxpayers who are affected by transfer pricing adjustments.

Australian taxpayer perspective

As the profile of international tax arbitration increases, it is likely that certain taxpayers will start calling for the ATO and the Treasury to consider arbitration provisions. Although the International Chamber of Commerce has long called for the option of arbitration,[81] Australian taxpayer groups, even in the industries most affected by transfer pricing adjustments and MAPs, have not yet lobbied publicly for this reform.

Talking with Australian advisers, it is clear that although taxpayers do not routinely deride Australia's MAP, some are very frustrated by MAPs that drag on for several years and become more trouble than the double taxation relief is worth. There is an emerging consensus among these advisers that arbitration is a desirable option to have, if only for its "spectral" role in increasing the speed and

[78] Bell, n 19. In addition, in April of this year, the New York State Bar Association Tax Section noted the absence of an arbitration provision in the latest United States Model Treaty and called for the United States Treasury to state its views on and experience with tax arbitration to date: New York State Bar Association, *Model Income Tax Convention Released by the Treasury*, Report No 1127 (2007), http://www.nysba.org/MSTemplate.cfm?Section=Reports_20071&Site=Tax_Section1& viewed July 2007.

[79] Crest S, "US to Arbitrate Tax Disputes" (2007) (Mar) *International Tax Review*, http://www.internationaltaxreview.com/includes/magazine/PRINT.asp?SID=677867&ISS=23497&PUBID=35 viewed July 2007.

[80] A similar approach is described in Bell, n 48.

[81] From general calls to address double taxation in 1920 to specific submissions on international tax arbitration from 1984 to 2002: see Altman, n 3, p 88, and also n 18 above.

efficacy of the MAP. This is a good pragmatic view, although Ellis notes that it is somewhat counterintuitive: "I am reminded of the man who always buys his shoes a size too small because it is then so nice to take them off."[82] Of course, if over a long period arbitration is available but never utilised then its ability to loom convincingly over a MAP will be impaired.

The MAP and arbitration are of particular importance to those Australian taxpayers who are affected by transfer pricing adjustments because Australian taxpayers are notably less active in transfer pricing litigation than their counterparts in the United States and other countries.[83] Only one transfer pricing case has been fully litigated in the Australian courts in modern times.[84] The taxpayer's usual task in litigation, to prove that the assessment is excessive,[85] may be difficult when that assessment is a transfer pricing assessment.[86] One particular feature of such assessments is that the Commissioner of Taxation selects the arm's length price from any number of prices rather than just making a binary decision to either apply a legislative provision or not apply it. In addition, transfer pricing cases can involve large volumes of documentary and expert evidence, call for intricate factual findings, and impact on corporate reputation, so litigation is often a costly and risky prospect for the taxpayer.[87]

Against these difficulties, the ATO's compliance agenda continues to focus on "profit shifting" arrangements,[88] and Ernst & Young notes an emerging trend of divergence of specific approaches to transfer pricing, despite increased in-principle agreement, among tax authorities globally.[89] Australian taxpayers aggrieved by transfer pricing adjustments who find the choice between litigation, settlement and the uncertain MAP to be unpalatable are likely to be a source of support for arbitration provisions.

An additional stimulus may come from financial reporting standards. In July 2006, the Financial Accounting Standards Board released FIN 48 "Accounting for Uncertainty in Income Taxes", which is likely to be incorporated at least to a degree into Australian standards over the next few years. FIN 48 mandates more specific rules about the measurement, disclosure and documentation of uncertain tax positions. Since the MAP features no obligation to reach resolution, it is possible that taxpayers who are engaged in a MAP, or have taken aggressive transfer pricing positions and are therefore potential candidates for MAP, may be subject to more onerous disclosure requirements if and when these new rules come into effect. In this regard, the existence of the option to arbitrate may help taxpayers to better estimate their tax risks for financial reporting purposes.

Given these considerations, the general conclusion that it is desirable to provide taxpayers with the option of arbitration also applies specifically to Australian taxpayers. In Australia, the arguments for international tax arbitration are as yet diffuse. This article is intended to stimulate debate about the appropriateness for Australia of this new institution. Although the arbitration movement is only getting off the ground, Australia should actively consider it rather than wait to see how it works overseas. Taking the latter course will mean that when the idea of arbitration is foisted upon Australia by another country in a treaty negotiation, Australia will be unprepared to make the decisions necessary to make arbitration work to its advantage.

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[82] Ellis, n 17 at 100.

[83] Jones B, "Transfer Pricing: The Process and Validity of Assessments" (2002) 5(4) *The Tax Specialist* 186 at 186; Ernst & Young Survey, n 23, p 31.

[84] *FCT v Commonwealth Aluminium Corp Ltd* (1980) 143 CLR 646; 11 ATR 42.

[85] Section 14ZZO of the *Taxation Administration Act 1953* (Cth).

[86] For example, see the recent interlocutory judgments in *WR Carpenter Holdings Pty Ltd v FCT* [2007] FCAFC 103; and *Syngenta Crop Protection Pty Ltd v FCT* (2005) 61 ATR 186; [2005] FCA 1646 (which concerned a motion by American Express International Inc, as well as that by Syngenta).

[87] Lingane A, "Transfer Pricing – Practical Issues in the Asia Pacific Region: Part 2" (2006) 9(5) *The Tax Specialist* 264 at 268.

[88] ATO Compliance Programs, n 28.

[89] Ernst & Young Survey, n 23, p 5.

APPENDIX 1 – MUTUAL AGREEMENT PROCEDURE CASE DATA

Obtained from Australian Taxation Office, International Strategy and Operations, March 2007.

TABLE A Transfer pricing (TP) cases, 1 July 2000-1 July 2006

TP cases 1999-2006	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Cases on hand at 1 July	23*	14	18	26	25	19	11	12
New cases commenced in year	7	6	10	14	11	4	4	
Cases finalised in year (initiated by Australia, initiated by other countries)	4 (4, 0)	15 (5, 10)	6 (5, 1)	6 (5, 1)	12 (7, 5)	10 (5, 5)	13 (8, 5)	
Finalised cases – countries involved	Japan, NZ	Canada, Germany, Japan, US	Japan, US	Japan, UK, US	Canada, Germany, Japan, Korea, US	Canada, Denmark, Germany, Japan, Korea, US	Canada, Germany, Italy, NZ, UK, US	
Finalised cases – average time taken to resolve case	2.53 years	3.11 years	2.01 years	1.09 years	1.95 years	2.33 years	2.12 years	
Cases finalised that took longer than 2 years based on available data	2	9	5	0	5	7	7	

* The author notes that this figure does not reconcile with the on-hand 1999 figures in the other tables.

TABLE B Non-transfer pricing cases, 1999-2006

Non-TP cases 1999-2006	1999-2001	2002-2006
Cases on hand	2	6
New cases commenced in period	6	13
Cases finalised	2	11
Cases rejected	Data not available	1
Cases withdrawn	Data not available	1
Cases initiated by Australia	Data not available	14
Cases initiated by other countries	Data not available	5
Issues resolved	Data not available	10
Issues unresolved	Data not available	1
Finalised cases - average time taken to resolve case	Data not available	3 years
Percentage of cases that took longer than two years to complete	Data not available	82%

TABLE C All cases (transfer pricing and non-transfer pricing), 1987-1999

All cases (TP and non-TP)	1987-1999
Cases on hand at start 1987	12**
Cases finalised	57
Cases withdrawn	5
Unresolved cases	0
Partially resolved cases	1
Cases initiated by Australia	38
Cases initiated by other countries	39
Percentage of cases that took longer than two years to complete	48%

** The author notes that this is a different figure from the equivalent statistic in Friezer's study at n 8.