

A Primer on tax treaty arbitration procedure

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In February 2007, the Organization for Economic Co-operation and Development (OECD) published the Report adopted by its Committee on Fiscal Affairs (CFA) on January 30, 2007: “Improving the Resolution of Tax Treaty Disputes”.² The main feature of the OECD Report is to supplement the current dispute resolution procedure – the mutual agreement procedure (MAP) – by mandatory arbitration. The Report calls for the insertion of a new paragraph 5 in Art. 25 of the OECD Model Tax Convention, provides amendments to the Commentary to the Model Tax Convention and a draft of a mutual agreement to be entered into by the Contracting States to set out the specifics of the arbitration procedure.³ The author, both a tax and an international arbitration practitioner, outlines the procedure for tax treaty arbitration.



Arbitration: supplement to MAP

OECD has made it clear that tax treaty arbitration is not an independent judicial dispute resolution mechanism but rather a supplement to the MAP under Art. 25 Model Tax Convention: “Recourse to these [i.e., dispute resolution] techniques, however, must be an integral part of the mutual agreement procedure and should not constitute an alternative route to solving tax treaty disputes between States, which would risk undermining the effectiveness of the mutual agreement procedure”.⁴

Tax treaty arbitration is mandatory; no prior authorisation by the competent authorities is necessary. Once the requisite procedural requirements have been met, the unresolved issues must be submitted to the arbitrators for decision.⁵ In that OECD tax treaty arbitration differs from arbitration already provided for by several existing tax treaties where arbitration requires prior agreement of the competent authorities. However, as of 2005, no cases had ever been brought to arbitration under these provisions; doubts about their usefulness appear to be justified.

Domestic remedies

As in investment treaty arbitration, the taxpayer, when filing a request for arbitration, must supply a declaration signed by it and any affiliated party affected by the case that no decision on the same issues has already been rendered by a court or administrative tribunal of the Contracting States.⁶

This is consistent with the situation with respect to MAP in most countries: a person cannot pursue simultaneously MAP and domestic legal remedies. If such remedies are still available, the competent

authority either requires that the taxpayer agree to the suspension of these remedies or, if the taxpayer does not agree, will delay MAP until these remedies are exhausted. If MAP is first pursued and agreement has been reached, the taxpayer may reject such agreement and pursue domestic remedies that have been suspended. Should the taxpayer favour the agreement reached in MAP to apply, then he must renounce the exercise of domestic legal remedies as regards the issue covered by the agreement. If domestic legal remedies are pursued and are exhausted in one Contracting State, only MAP in the other Contracting State is available as most countries consider it impossible to override such a final decision in MAP. The same basis rules apply to arbitration.⁷

Experience with MAP has shown that in most cases where agreement has been reached in MAP, the taxpayer accepts such agreement. It is therefore fair to say that it is unlikely that the agreement reached by the competent authorities following the arbitration decision will be rejected and domestic legal remedies will be pursued instead.⁸

The taxpayer's process

The taxpayer can initiate the arbitration proceedings by filing a request for arbitration with one of the competent authorities no earlier than two years after the date on which the case presented to the competent authority pursuant to Art. 25(1) Model Tax Convention was forwarded by that authority to the other competent authority. The request shall be made in writing and be accompanied by a statement in writing of each of the persons who either made the request or is directly affected by the case – in

transfer pricing disputes, the other party to the transaction – that no decision on the same issue has already been rendered by a court or administrative tribunal of the Contracting States.⁹ There is no advance of costs to be made by the taxpayer.¹⁰

The competent authorities' process

Within 10 days, the competent authority who received the request for arbitration shall send a copy of the request and accompanying statements to the other competent authority.¹¹

Terms of Reference: the blueprint of the arbitration

Within three months after the request for arbitration has been received by both competent authorities, they shall agree on the questions to be resolved by the arbitration panel and communicate them as 'Terms of Reference' in writing to the taxpayer. The competent authorities may also provide procedural rules that are additional to, or different from, the Mutual Agreement on Arbitration and deal with other matters as are deemed appropriate.¹²

The Terms of Reference constitute the jurisdictional basis for the questions to be decided by the arbitration panel.¹³ The competent authorities may draft the Terms of Reference in such a way that the *whole* case and not just certain specific issues are submitted to arbitration.¹⁴

If within three months after that the request for arbitration has been communicated to both competent authorities, the Terms of Reference have not been communicated by the competent authorities to the taxpayer, the competent authorities and the taxpayer may, within one month after that period, communicate in writing to each other the list of issues to be resolved through arbitration, which list shall then constitute the tentative Terms of Reference.¹⁵

Within one month after the appointment of all arbitrators, the arbitrators shall communicate to the competent authorities and to the taxpayer a revised version of the tentative Terms of Reference.

Within one month after the revised version for the tentative Terms of Reference has been received by both of them, the competent authorities may agree on different Terms of Reference and communicate them in writing to the arbitrators and to the taxpayer. These different Terms of Reference constitute the Terms of Reference for the case. If no such different Terms of Reference have been agreed to by the competent authorities and communicated within the period set, the revised version of the tentative Terms of Reference prepared by the

arbitrators shall constitute the Terms of Reference for the case.

Selection of arbitrators

Within three months after the Terms of Reference have been received by the taxpayer or, if the competent authorities cannot agree upon the Terms of Reference, four months after the request for arbitration has been received by both competent authorities, each competent authority shall appoint an arbitrator.¹⁶

If any appointment is not made within the required time period, the arbitrator(s) not yet appointed will be appointed by the Director of the OECD Centre for Tax Policy and Administration within 10 days of receiving a request to that effect from the taxpayer.

The same procedure applies if the replacement of an arbitrator becomes necessary.

Any person, including a government official of a Contracting State, may be appointed as arbitrator unless that person has been involved in prior stages of the case. A justification for the waiver of the requirement of neutrality is given in *Comment to MA on Arb.*, para. 5: "There may be advantages in having representatives of each Contracting State appointed as arbitrators as they would be familiar with this type of issue. Thus it should be possible to appoint to the panel governmental officials who have not been directly involved in the case. Once an arbitrator has been appointed, it should be clear that his role is to decide the case on a neutral and objective basis; he is no longer functioning as an advocate for the country that appointed him."

Selection of the Chair

Within two months of the latter appointment, the arbitrators so appointed shall appoint the third arbitrator who will function as the Chair. If they fail to do so, the Chair will be appointed by the Director of the OECD Centre of Tax Policy and Administration within 10 days after having received a corresponding request from the taxpayer.¹⁷

Streamlined arbitration

The competent authorities may agree in the Terms of Reference on a streamlined arbitration process with the following particularities¹⁸:

The issues are decided by a sole arbitrator to be appointed by the competent authorities within one month after receipt of the Terms of Reference by the taxpayer and, failing them, by the Director of the OECD Centre for Tax Policy and Administration within 10 days after receipt of a corresponding request by the taxpayer.

Within two months from the appointment of the sole arbitrator, each competent authority shall present in writing its own reply to the questions contained in the Terms of Reference.

Within one month after having received the last of the replies from the competent authorities, the sole arbitrator shall decide and shortly motivate each question included in the Terms of Reference in accordance with one of the two replies received from the competent authorities.

Para. 13 of the *Comments to MA on Arb.* explains the streamlined procedure: “*The process, which will then override other procedural rules of the sample agreement, takes the form of the so-called ‘last best offer’ or ‘final offer’ arbitration, under which each competent authority is required to give to an arbitrator appointed by common consent that competent authority’s own reply to the questions included in the Terms of Reference and the arbitrator simply chooses one of the submitted replies.*”

Such procedure is said to be suitable if primarily factual issues are at stake, often arising in transfer pricing disputes where the unresolved issue may be simply the determination of an arm’s length transfer price or range of prices, on the one hand, or in determination of the existence of a permanent establishment, on the other hand.

The arbitrators’ process

As a consequence of the characterisation of arbitration as a supplement to MAP, the arbitral process does not result in the case to be decided by the arbitrators; rather the *issues* upon which the competent authorities have been unable to reach agreement are decided by the arbitrators for the competent authorities’ benefit. Preliminary issues already decided by the competent authorities cannot be reopened by the arbitrators; the competent authorities’ decision is binding on the arbitrators. Eventually, based on the arbitrators’ determination of the disputed *issues*, the competent authorities will then decide the case and thereupon close the MAP.

This limitation of the arbitrators’ power distinguishes tax treaty arbitration from other forms of commercial or government-private party arbitrations where the jurisdiction of the arbitrators extends to resolving the whole case.¹⁹

Setting procedural rules

The procedural and evidentiary rules are those established in the Contracting States’ Mutual Agreement on Arbitration, those agreed upon by the competent authorities in the Terms of Reference or as adopted by the arbitrators.²⁰

The arbitrators will have access to all information necessary to decide the issues submitted to them, including confidential information.²¹ Unless the competent authorities agree otherwise, any information that was not available to both competent authorities in MAP shall not be taken into account for the purposes of the decision.²²

Participation of the taxpayer

The taxpayer may present his position to the arbitrators in writing and, with the permission of the arbitrators, may also present his position orally during the arbitration proceedings.²³ The earlier Discussion Draft specifically empowered the competent authorities to provide otherwise in the Terms of Reference. This possibility for the competent authorities to curtail the taxpayer’s right to intervene has been dropped.

Logistical arrangements

Unless agreed otherwise by the competent authorities, the competent authority to which the case giving rise to the arbitration was initially presented shall be responsible for all the logistical arrangements for the meetings of the arbitration panel and shall provide the administrative personnel necessary for the conduct of the arbitration process.

The administrative personnel shall report only to the Chair concerning any matter related to the process.

Taking of arbitration decision – publication

Where more than one arbitrator has been appointed, the arbitration decision shall be determined by a simple majority of the arbitrators.²⁴ Unless provided otherwise in the Terms of Reference, the decision shall be motivated in writing and, with the permission of the taxpayer, may be made public in a redacted form.

Time for arbitration decision

The arbitration decision must be communicated to the competent authorities and to the taxpayer within six months after the Chair’s declaration that he has received all the information necessary to begin consideration of the case.²⁵

If the decision is not communicated within the time period set, the competent authorities may agree to extend that period by a period not exceeding six months or, if they fail to do so, within one month from the end of the period they shall appoint new arbitrators.²⁶

Costs

The OECD Report provides for the fees of the arbitrators to be dealt with specifically in the Contracting States' Mutual Agreement on Arbitration²⁷ and refers to the EC Arbitration Convention²⁸ as a possibility: "The fees should be large enough to ensure that appropriately qualified experts could be recruited. One possibility would be to use a fee structure similar to that established under the EU Arbitration Convention Code of Conduct".²⁹

The EU Code of Conduct of March 31, 2005 for the effective implementation of the Arbitration Convention³⁰ provides in its para. 4.3(f) as follows: "Unless the competent authorities of the Contracting States concerned agree otherwise:

- (i) the reimbursement of the expenses of the independent persons of standing will be limited to the reimbursement usual for high ranking civil servants of the Contracting State which has taken the initiative to establish the advisory commission;
- (ii) the fees of the independent persons of standing will be fixed at €1000 per person per meeting day of the advisory commission, and the Chairman will receive a 10% higher fee than the other independent persons of standing;
- (iii) Actual payment of the costs of the advisory commission procedure will be made by the Contracting State which has taken the initiative to establish the advisory commission, unless the competent authorities of the Contracting States concerned decide otherwise."

The OECD Report deals with costs as follows:³¹

1. Each competent authority and the taxpayer bear their own expenses.
2. Each competent authority bears the costs of the arbitrator appointed by it or for it by the Director of the OECD Centre for Tax Policy and Administration.
3. The costs of the Chair are borne equally by the two Contracting States.
4. The costs of the meetings and of the administrative personnel necessary are borne by the competent authority to which the case was initially presented.
5. All other costs, including costs of translation and recording, "related to expenses that both competent authorities have agreed to incur"³² are borne equally by the two Contracting States.

Resolution of the case

The competent authorities shall implement the arbitration decision within six months after communication by reaching a mutual agreement on the case that led to arbitration.³³

Failure of the competent authorities to assess the taxpayer in accordance with the arbitration

decision would result in taxation not in accordance with the tax treaty and, as such, allows the taxpayer to seek relief through domestic legal remedies or by making a new request for arbitration.³⁴

Notwithstanding the institution of the arbitration procedure, the competent authorities can at any time end the arbitration (even if the taxpayer does not agree) by amicably finding a solution of the case, provided it does resolve double taxation. However, the competent authorities can not avoid arbitration by simply 'agreeing not to agree'.

Notes:

- 1 Partner, Walder Wyss & Partners, Zurich, Switzerland.
- 2 Available at the OECD website: <http://www.oecd.org/dataoecd/17/59/38055311.pdf>
- 3 Here referred to as „ MA on Arb.”.
- 4 Report, p. 4.
- 5 Commentary to Model Tax Convention, Art. 25, para. 45.
- 6 MA on Arb., para. 1.
- 7 Commentary to Model Tax Convention, Art. 27, para. 58.
- 8 Commentary to Model Tax Convention, Art. 25, para. 61.
- 9 MA on Arb., para 1 and 2.
- 10 Comments to MA on Arb., para. 2.
- 11 MA on Arb., para. 1.
- 12 MA on Arb., para 3.
- 13 Comments to MA on Arb., para. 9
- 14 Comments to MA on Arb., para. 10.
- 15 MA on Arb., para. 4, also with respect to the following.
- 16 MA on Arb., para. 5 also with respect to the following.
- 17 MA on Arb., para. 5.
- 18 MA on Arb., para. 6.
- 19 Commentary to Model Tax Convention, Art. 25, para. 46.
- 20 MA on Arb., para. 10 also with respect to the following.
- 21 MA on Arb., para. 8.
- 22 MA on Arb., para. 10.
- 23 MA on Arb., para. 11.
- 24 MA on Arb., para. 15.
- 25 MA on Arb., para. 16.
- 26 MA on Arb., para. 17.
- 27 MA on Arb., para. 6(a).
- 28 Convention 90/436/EEC of 23 July 1990 on the elimination of double taxation in connection with the adjustment on profits of associated enterprises, OJ L 225, 20 August 1990, at 10. Also available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:41990A0436:en:NOT>
- 29 Comments to MA on Arb., para. 29.
- 30 OJ C 176, 28 July 2006, at 8. Also available at: http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/c_176/c_17620060728en00080012.pdf
- 31 MA on Arb., para. 13.
- 32 MA on Arb., para. 13(e).
- 33 MA on Arb., para. 19.
- 34 Comments to MA on Arb., para. 42.

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