



**Issue : Provisional**  
**Published : March 2007**

This article will be published in a future issue of TDM (2007). Check website for final publication date for correct reference.

This article may not be the final version and should be considered as a draft article.

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## Arbitration of Tax Treaty Disputes - The 2008 OECD Model for income tax treaties will contain an arbitration clause by A.E. Gildemeister

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# Arbitration of Tax Treaty Disputes

The 2008 OECD Model for income tax treaties will contain an arbitration clause

by Arno E. Gildemeister<sup>1</sup>

On 30 January 2007, OECD countries have agreed to include an arbitration provision in article 25 paragraph 5 of the 2008 OECD Model Tax Convention on Income and Capital<sup>2</sup>. The OECD Model serves and has served as a basis for the majority of bilateral tax treaties. It can therefore be expected that the newly published amendment will strongly favour the inclusion of arbitration clauses in future bilateral tax treaties and promote the revision of existing treaties.

The proposed arbitration provision would oblige the tax administrations of the treaty states to enter into an arbitration procedure if they are unable to reach an agreement by way of the so-called mutual agreement procedure (MAP) within two years. Arbitration would thus be mandatory for the competent authorities and the result would be binding on the treaty states.

This article describes the factors that have led to the insertion of an arbitration clause and the approach that the OECD has taken. It evaluates the major improvements and highlights some critical points. In the last part, the author will offer ideas for future improvement.

## I. The Mutual Agreement Procedure and its Insufficiencies

The classic means to resolve disputes regarding the application of double taxation treaties is the so-called mutual agreement procedure (MAP).

### 1. Description of the Mutual Agreement Procedure

A mutual agreement procedure is initiated at the request of a taxpayer, usually a business company who claims that it is overtaxed because one of the treaty states did not apply the tax treaty accurately or because the application of the treaty in the two states is inconsistent. Typically, such disputes concern transfer pricing issues, the valuation of intangibles or services or the existence of a residence or a permanent establishment.

The taxed company addresses its claim to the "competent authority" of the contracting state of which it is a resident. If the competent authority considers the claim to be justified and if it is not itself able to remedy it, it shall present the case to the competent authority of the other state. They together "shall endeavour"<sup>3</sup> to find a solution.

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<sup>2</sup> [http://www.oecd.org/document/40/0,2340,en\\_2649\\_34897\\_38057000\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/40/0,2340,en_2649_34897_38057000_1_1_1_1,00.html).

<sup>3</sup> E. g. article 25 paragraph 2 of the OECD Model.

The parties to the mutual agreement procedure are the “competent authorities” of the treaty states, not the taxpayer itself who initiated it. The competent authorities are free to determine what approach they will pursue to reach a mutual agreement and if they take into account the interests of the particular taxpayer. Consequently, the mutual agreement procedure can be terminated without even reaching any mutual agreement. The taxpayer neither has a guarantee to get, by way of the “MAP”, a solution in accordance with the substantive provisions of the treaty nor even a right to significantly influence the procedure.

Normally, the treaty states try to avoid a situation where the outcome of a mutual agreement procedure would contradict the decision of a domestic court. Therefore, taxpayers would have to agree to a suspension of their domestic tax proceedings before a mutual agreement procedure is launched<sup>4</sup>. It should be noted, however, that the payment of taxes is not necessarily suspended during a mutual agreement procedure<sup>5</sup>.

If, at the end of the mutual agreement procedure, a mutual agreement is found, it is presented to the taxpayer who can then either accept or reject it. If the taxpayer accepts it, the mutual agreement becomes legally binding, which means that the taxpayer would definitely waive all remedies of domestic law<sup>6</sup>. Conversely, if no mutual agreement is reached or if a mutual agreement is rejected, the taxpayer can still pursue or resume the available domestic remedies which, until then, have only been suspended.

## 2. Insufficiencies of the mutual agreement procedure

In a majority of cases, mutual agreement procedures have produced satisfactory results. Eighty to 90 percent of cases are resolved within three to four years<sup>7</sup>. Still, given the growing number and complexity of international tax disputes, sometimes being subject to political pressure due to shrinking tax revenues, the number of mutual agreement procedures without any actual outcome has steadily increased<sup>8</sup>.

It often is, in fact, the high end, multi-million or billion dollar cases that remain unresolved. In such cases, the taxed companies only have the choice to file their claim again in the respective jurisdictions, often with little hope for relief, or to pay the tax demanded by both states.

Failure to resolve a mutual agreement case not only leads to **double taxation**. Usually, the taxed enterprise has also spent considerable **amounts for the whole process** (e.g. for the written submissions drafted by highly qualified and equally highly rewarded lawyers).

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<sup>4</sup> See N° 58 of the official OECD Commentary to article 25 which has also been amended and will be published together with the amendment of the Model Tax Convention in 2008.

<sup>5</sup> See, however, the OECD's recommendation to suspend the collection of taxes during a MAP: Best Practice N° 21 of the Manual on Effective Mutual Agreement Procedures (MEMAP), available on [http://www.oecd.org/document/39/0,2340,en\\_2649\\_34897\\_37989799\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/39/0,2340,en_2649_34897_37989799_1_1_1_1,00.html) .

<sup>6</sup> See N° 31 of the existing OECD Commentary to article 25.

<sup>7</sup> According to Jeffrey Owens, Head of the OECD's Centre for Tax Policy and Administration, cited in The Financial Times of 8 February 2007.

<sup>8</sup> According to the OECD, see [http://www.oecd.org/document/22/0,2340,en\\_2649\\_34897\\_38057000\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/22/0,2340,en_2649_34897_38057000_1_1_1_1,00.html).

The legal costs, however, are not matched by the possibility to influence the procedure: according to the OECD Model, the taxed enterprise has **no right to participate in the procedure**, e.g. a comprehensive right to be heard, except by formulating its claim at the outset and submit its statements. While the OECD has recently pointed out that it would be “good practice” to take a more inclusive approach and to brief the taxpayer regularly about the process, this can not be considered “common practice”<sup>9</sup>.

**Uncertainty and unpredictability<sup>10</sup> as to the outcome** have, of course, not encouraged taxpayers to request mutual agreement procedures. But even if a particular taxpayer does so, the very limited rights to participate, together with a **lack of transparency of the procedure and the absence of legally reasoned decisions<sup>11</sup>** increase the likelihood that the taxpayer will reject the mutual agreement the competent authorities have reached.

Where a mutual agreement procedure does not produce a satisfactory result, this usually brings about one or **more lawsuits** in the concerned states. The **doubled procedures** resulting therefrom present a **considerable delay**: the duration of a failed mutual agreement procedure which has to be added to that of subsequent domestic proceedings is normally several years<sup>12</sup>. Supposed, that considerable amounts of taxes have already been paid and given the significance of available capital in modern fast-developing business sectors, this can come close to a “denial of justice”.

These insufficiencies have led to understandable dissatisfaction and provoked criticism among the business community. Partly in response to this criticism, the OECD has launched a project on improving the resolution of cross-border tax disputes in 2003. A working group has been charged with examining ways of improving the effectiveness of the mutual agreement procedures, including the consideration of other, supplementary dispute resolution techniques. This initiative, after extensive consultation with the business community and with OECD and non-OECD countries, finally has brought about the arbitration amendment adopted on 30 January 2007.

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<sup>9</sup> “Best Practice N° 14” of the Manual on Effective Mutual Agreement Procedures (MEMAP) says:

“For tax administrations, timely and frequent communication with the taxpayer regarding the status or issues of a case will increase transparency in the process and help to ensure a clearer understanding of the case usually resulting in a faster and more appropriate resolution. Whilst giving due respect to the confidentiality of government to government communications and without allowing taxpayers to become involved in the actual MAP negotiations, competent authorities are encouraged to consider obtaining input from the taxpayer on factual and legal issues that may arise in the course of the MAP.”

MEMAP is available on [http://www.oecd.org/document/20/0,2340,en\\_2649\\_34897\\_36195732\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/20/0,2340,en_2649_34897_36195732_1_1_1_1,00.html), see also [http://www.oecd.org/document/7/0,2340,en\\_2649\\_34897\\_36195783\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/7/0,2340,en_2649_34897_36195783_1_1_1_1,00.html).

<sup>10</sup> It has to be noted that there are almost no published mutual agreements.

<sup>11</sup> In “Best Practice N° 17” of its “MEMAP”, the OECD has recently pointed out that it would be “good practice” for the competent authorities to deliver a “decision summary” sustaining the proposed mutual agreement. In fact, besides the requirements of domestic administrative law, there is no duty for the competent authorities to base their decision on any legal reasoning. That is why the competent authorities dealing with more than one case at once, have exposed themselves to criticism to do a mere horse-trading (“you give us this, so we give you that”).

<sup>12</sup> David R. Tillinghast reports a mutual agreement case between the US and Japan which was unresolved after more than ten years: “Issues in the implementation of the arbitration of disputes arising under income tax treaties”, Bulletin for International Fiscal Documentation Vol. 56 N° 3 (march 2002) p. 90.

## **II. The proposed arbitration supplement**

The newly adopted arbitration provision contained in article 25 paragraph 5 of the Model refers to paragraphs 1 and 2 of the same article, i.e. the mutual agreement procedure. It reads:

**“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.**

*[Text of the footnote, which would appear on the same page:]*

*In some States, national law, policy or administrative considerations may not allow or justify the type of dispute resolution envisaged under this paragraph. In addition, some States may only wish to include this paragraph in treaties with certain States. For these reasons, the paragraph should only be included in the Convention where each State concludes that it would be appropriate to do so based on the factors described in paragraph 47 of the Commentary on the paragraph. As mentioned in paragraph 54 of that Commentary, however, other States may be able to agree to remove from the paragraph the condition that issues may not be submitted to arbitration if a decision on these issues has already been rendered by one of their courts or administrative tribunals.”*

## 1. The basic features of the new arbitration provision

- **Supplementary arbitration:** The arbitration procedure provided for in the new paragraph can only be requested if “*the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 [i.e.: by way of a MAP] within two years*”. This means that it is a supplement rather than an alternative to the mutual agreement procedure. It can not be pursued instead of a MAP, but simply as an annex to it, a kind of “tie-breaker” for situations of deadlock<sup>13</sup>.

- **Mandatory arbitration:** For the same reason the arbitration is mandatory: unresolved issues<sup>14</sup>, “*shall be submitted to arbitration*” if the taxpayer so requests. The formulation “*shall*” is to be interpreted in the sense of “*have to*”. This is clarified in n° 45 of the (also amended) official OECD Commentary<sup>15</sup>. It states that arbitration “*is not dependent on a prior authorization by the competent authorities*”. By adopting the treaty, the states submit themselves to arbitration, just like the parties to a commercial contract who include an arbitration clause in their contract. The competent authorities cannot withdraw this consent “*once the requisite procedural requirements have been met*”<sup>16</sup>, i.e. the request for a mutual agreement procedure, the remaining of unresolved issues after a period of two years and the request for arbitration. The arbitration clause thereby imposes a “deadline” to the mutual agreement procedure which is deemed to incite the competent authorities to reach a mutual agreement before the end of the two years period. This incentive was in fact one of the main arguments for the OECD to provide for mandatory arbitration<sup>17</sup>.

- **...but no “right to arbitration” for the taxpayer:** Nevertheless, arbitration is only mandatory for the competent authorities as long as there are “*unresolved issues*”. If the competent authorities have presented a mutual agreement to the taxpayer, and be it only that they agree that there has *not* been taxation not in accordance with the treaty, there are no unresolved issues which can be brought to arbitration<sup>18</sup>. Therefore, the taxpayer has no right to arbitration against the common will of both competent authorities, and that even in cases where the reached agreement does not represent a correct application of the substantial provisions of the treaty. No arbitration will take place unless at least one competent authority defends the interests of the taxpayer. For the taxpayer, the arbitration provision therefore does not stipulate a genuine legal recourse.

- **Embedded arbitration:** Paragraph 5 speaks of the “*mutual agreement that implements the arbitration decision*”. Accordingly, the result is not an “arbitration award”, enforceable on its own<sup>19</sup>, but merely part

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<sup>13</sup> The OECD never envisaged to introduce an alternative to the mutual agreement procedure: [http://www.oecd.org/document/26/0,2340,en\\_2649\\_34897\\_2508762\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/26/0,2340,en_2649_34897_2508762_1_1_1_1,00.html).

<sup>14</sup> This concerns only issues arising from the claim that there was “taxation not in accordance with the provisions of this Convention”, see Article 25 paragraph 5.

<sup>15</sup> The official OECD Commentary is a widely recognised guide for the interpretation of bilateral tax treaties. Thus, it plays an important role in the harmonisation of international tax law, even if it is not formally binding from a perspective of public international law. The amended Commentary will be published together with the 2008 OECD Model Tax Convention.

<sup>16</sup> N° 45 of the Commentary, see footnote above.

<sup>17</sup> See N° 13 of the Report adopted on 30 January 2007 (pages 4 – 5).

<sup>18</sup> See N° 46 and 53 of the official Commentary on the 2008 Model.

<sup>19</sup> One can therefore conclude that the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (10 June 1958) is not applicable.

of the final mutual agreement. One can conclude that the arbitration procedure is totally embedded in the mutual agreement procedure. It is not a review procedure to the “MAP” but a simple extension of it, an “excursus”. Only the “*particular issue which is preventing agreement in the case*” is subject to arbitration while the case as a whole continues to be resolved through the mutual agreement procedure<sup>20</sup>.

- **No “supranational” recourse:** There is no hierarchy or subordination between the national level and the international “MAP-arbitration” level: in terms of substantial tax law, the claim must concern “*taxation not in accordance with the provisions of this Convention*” so that the arbitrators can not decide contentious<sup>21</sup> issues of national tax law. In terms of procedure, the envisaged arbitration would not provide for a review of decisions rendered by domestic tax courts. This is ensured by the wording that “*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.*” The relationship between arbitration and domestic legal remedies would be the same as in the classic mutual agreement procedure: the taxpayer, in order to obtain an arbitration, would have to suspend domestic remedies and, in the end, waive them in order for the mutual agreement to become binding<sup>22</sup>.

- **Binding outcome:** The decision of the arbitrators “*shall be binding on both Contracting States and shall be implemented*”. Of course, the whole purpose of arbitration is about reaching a binding result, even against the will of one competent authority. It is not obvious, however, why the competent authorities should not have the possibility to depart from the arbitration decision concurrently<sup>23</sup>. In commercial arbitration, for instance, nothing prevents the parties to a case to reach a settlement, and that even after the arbitral award has been rendered. But from a practical point of view and considering the particular situation of the affected taxpayer, it seems much better to have the participating competent authorities abide by the arbitral decision. That is why the OECD chose to provide for a binding effect of the outcome.

- **...but not binding on the taxpayer:** On the other hand, the outcome is binding only “*unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision*”. Hence, the decision would bind the states but not the taxpayer or other “affected” persons who can still reject it. This asymmetry is logical, given that the taxpayer was not a party to the procedure. In fact, extending the binding effect to the taxpayer without giving him comprehensive procedural rights (rights to be heard etc.) would be highly questionable in view of the principle of due process. On the other hand, the OECD solution has the practical inconvenience of wasted time and resources, should the taxpayer reject the outcome. This waste of resources would be even more annoying when a third “affected”

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<sup>20</sup> Pursuant to N° 46 of the Commentary, see footnotes above.

<sup>21</sup> But they can consider the rules of national law. That is why the proposed mode of application of the arbitration clause (see below) reads: “The arbitrators shall decide the issues submitted to arbitration in accordance with the applicable provisions of the treaty and, **subject to these provisions**, of those of the domestic laws of the Contracting States.”

<sup>22</sup> See N° 58 and 64 of the Commentary. The Commentary reflects also two alternative approaches according to which the taxpayer would not have to suspend domestic remedies (N° 56 and 58) or would have to waive them before he can request arbitration (N°64).

<sup>23</sup> See article 12 of the EU Arbitration Convention (436/90 EEC) according to which the states can back out concurrently. N° 66 of the Commentary refers to this provision and proposes a similar (though not identical!) alternative paragraph 5 according to which the competent authorities, together with the persons directly affected (i.e. the taxpayer), are given the possibility to depart from the arbitration decision.

person<sup>24</sup> rejects the outcome so that the taxpayer who, presumably, would be happy to have obtained a mutual agreement after years of waiting, goes away empty-handed.

The last sentence of the arbitration provision refers to a mutual agreement between the competent authorities settling the “**mode of application of this paragraph**”. This would be a set of procedural rules to be applied to a multitude of cases between the respective treaty states. It would for instance fix the form of the arbitration request, the applicable time frames, the drafting of the terms of reference, the mode of selection and appointment of the arbitrators, the participation of the taxpayer, the applicable substantial and procedural rules, the form and the time frames for the arbitration decision as well as its implementation, the bearing of the costs and other rules which could provide guidance during the arbitration.

In its Annex to the Commentary, the OECD will include a “sample agreement” which can serve as a model for the “mode-of-application-agreement”. Some interesting rules contained in this sample agreement shall be outlined below.

## 2. The proposed mode of application of the arbitration provision

To everyone familiar with the practice of international arbitration, large parts of the sample agreement will not be surprising. It contains, however, some unusual clauses and even some questionable. Since the purpose of this article is not an in-depth analysis of each clause, I will briefly describe the content while concentrating on the rather “exotic” aspects of the sample agreement.

**Paragraph 1** of the sample agreement provides that the **request for arbitration** should be made in writing and presented to one of the competent authorities involved in the case. In **paragraph 2**, the Contracting States would have to specify the pieces of information that have to be included in the request.

According to **paragraph 3**, the competent authorities shall agree on the **terms of reference**, i.e. the questions to be resolved by the arbitration. The taxpayer, generally, has no say in the making of the terms of reference. In the terms of reference, the competent authorities can also specify procedural rules “*additional to or different from*” the ones laid down in the general procedural agreement (sample agreement). This is problematic because the taxpayer, when initiating the MAP (and agreeing to a suspension of domestic remedies) cannot foresee whether the competent authorities will depart from a given procedural rule which is meant to protect his rights (such as the possibility to submit written statements or the taking of evidence).

**Paragraph 5** which deals with the **selection of the arbitrators** is quite classical: the competent authorities shall each appoint one arbitrator and the two arbitrators so appointed will appoint a third acting as Chairman. Here again, the taxpayer has no possibility to interfere.

As for the **eligibility** of the arbitrators, **paragraph 7** provides that, “*any person, including a government official of one of the Contracting States, may be appointed as an arbitrator, unless that person has been involved in prior stages of the case that results in the arbitration process.*”

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<sup>24</sup> Curiously, the OECD Commentary contains no indication who should be regarded as an “affected person”.



The Commentary on paragraph 7 of the sample agreement adds: “15. *There is no need for the agreement to stipulate any particular qualifications for an arbitrator as it will be in the interests of the competent authorities to have qualified and suitable persons act as arbitrators and in the interests of the arbitrators to have a qualified Chair. However, it might be possible to develop a list of qualified persons to facilitate the appointment process and this function could be developed by the [OECD] Committee on Fiscal Affairs. It is important that the Chair of the panel have experience with the types of procedural, evidentiary and logistical issues which are likely to arise in the course of the arbitral proceedings as well as having familiarity with tax issues. There may be advantages in having representatives of each Contracting State appointed as arbitrators as they would be familiar with this type of issues. 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.*”

Government representatives arbitrating a case where their government is involved: that would be shocking news for every arbitration lawyer! It means that one of the fundamental rules of arbitration law, the principle of independence of the arbitrators is not safeguarded.

Yet, the absence of a strict independence rule in the OECD proposal has to be understood in its political context. In order to alleviate fears of some countries for their tax sovereignty, the OECD probably had to find a minimum consensus to achieve unanimity.

The practice will show, however, if bilateral agreements will be concluded which include a provision like the above and if, in the end, dependent government officials will act as arbitrators. In my view, the obviousness of the principles of independence and neutrality, together with the dynamics of international arbitration law might lead to a more sensitive approach. To assure the legitimacy of the whole procedure and also the credibility of the single arbitrator vis-à-vis his or her colleagues, it might well turn out that the states will rather appoint independent professors of international tax law or other qualified persons in the field of international tax or arbitration law.

**Paragraph 6** provides for a **streamlined procedure**. The streamlined procedure is meant to be leaner, cheaper and quicker than the “normal” procedure. The competent authorities do only appoint one arbitrator. Within two months from the appointment of the arbitrator, each competent authority presents to the arbitrator a proposal for solution. “*Within one month from having received the last of the replies from the competent authorities, the arbitrator will decide each question included in the Terms of Reference in accordance with one of the two replies received from the competent authorities as regards that question...*”.

This form of procedure called “**baseball arbitration**” or “last best offer arbitration” is already used in US domestic tax law<sup>25</sup> as well as in a few tax treaties<sup>26</sup>. Whereas it seems quite suitable for very factual

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<sup>25</sup> See for instance Kirsten J. Mc Donough: Resolving Federal Tax Disputes Through ADR, *Arbitration Journal* 6/93 p. 38.

<sup>26</sup> See, in this context also, a speech by US Treasury International Tax Counsel Hal Hicks at the International Taxation Conference, 5 June 2006 in which he indicates that “the US strongly supports the planned improvements in the MAP process and the use of arbitration. The US business community also supports this. Arbitration - both the judicial model and so-called “baseball” model - can be important tools for enhancing the Competent Authority process, by bringing another mechanism to bear to resolve disputes. Believe we will see arbitration provisions become a basic principle in future US treaty negotiations. [...] As reported recently, a baseball type arbitration provision is included in the recently signed US-Germany protocol.” ([http://www.oecd.org/document/15/0,2340,en\\_33873108\\_33873886\\_36938255\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/15/0,2340,en_33873108_33873886_36938255_1_1_1_1,00.html))

cases (e.g. the determination of a transfer price), it is less clear how it should be applied to complex legal questions. Among arbitration lawyers, it therefore has provoked both appraisal and criticism<sup>27</sup>.

**Paragraph 8** of the sample agreement allows the arbitrators full **access to the information** needed to resolve the issues submitted to arbitration. At the same time, they shall be subject to the same strict **confidentiality** requirements as apply to the competent authorities themselves. This certainly relates to concerns of multinational business companies who might fear that sensitive parts of the revealed information are communicated to their competitors.

**Paragraph 10** sets out that *“the arbitrators shall adopt those **procedural and evidentiary rules** that they deem necessary to answer the questions set out in the terms of reference.”* The Commentary to this paragraph concludes that *“the arbitrators are free to refer to existing arbitration procedures, such as the International Chamber of Commerce Rules which deal with many of these questions”*<sup>28</sup>.

The proposed **paragraph 11** confirms the general approach to give only little room for **taxpayer participation**: *“The person who made the request for arbitration may, either directly or through his representatives, present his position to the arbitrators in writing to the same extent that he can do so during the mutual agreement procedure. In addition, with the permission of the arbitrators, the person may present his position orally during the arbitration proceedings.”*

**Paragraph 13** deals with **costs** and stipulates that: *“a) each competent authority and the person who requested the arbitration will bear the costs related to his own participation in the arbitration proceedings [...]”*. This seems reasonable.

It is more questionable, however, that *“b) each competent authority will bear the remuneration of the arbitrator appointed exclusively by that competent authority [...]”* because it contributes to the perception that the arbitrators might not be independent.

According to **paragraphs 15 and 16**, the **decision** *“shall indicate the sources of law relied upon and the reasoning which led to its result”* and shall be communicated **“within six months** from the date on which the Chair notifies in writing the competent authorities and the person who made the request for arbitration that he has received all the information necessary to begin consideration of the case.”

The limitation to six months contained in paragraph 16 can be extended under certain circumstances. However, in that it imposes a general timeframe it ensures an expeditious solution of the case which should be welcomed.

**Paragraph 15** further provides: *“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 and with the understanding that the decision has **no formal precedential value.**”*

The benefits of published decisions are accurately described in the Commentary: *“[...] publishing the decisions would lend additional transparency to the process. Also, whilst the decision would not be in any sense a binding*

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<sup>27</sup> See for example Laurence Mitrovic: “L'arbitrage baseball: arbitrage ou mode alternatif de règlement?”, Rev. Arb. 2003 Vol. 4 p. 1166.

<sup>28</sup> N° 18 of the Commentary to the Annex.

*precedent, having the material in the public domain could influence the course of other cases so as to avoid subsequent disputes and lead to a more uniform approach to the same issue.*<sup>29</sup>

Pursuant to **paragraph 18**, the national courts shall **review the “integrity” of the procedure**, but not questions of substantive law: *“the arbitration decision shall be final, unless that decision is found to be unenforceable by the courts of one of the Contracting States because of a violation of paragraph 5 of Article 25 or of any procedural rule included in the Terms of Reference or in this agreement that may reasonably have affected the decision.”*

Given that the taxpayer can reject the arbitration decision anyway, this rule primarily seems to aim at a protection of the treaty states. On the one hand, the mere existence of a review possibility could raise the standards of conduct within tax treaty arbitrations. On the other side, however, the review provision could turn out to become a loophole for tax authorities unwilling to enforce the arbitration decision. This risk is particularly relevant because the wording of the provision does not clearly define which situations shall be covered by this “procedural review” and which issues can be invoked against an arbitration decision.

Should it really be possible to invoke before a national court, that the competent authority of the other state, *“contrary to article 25 paragraph 5 of the treaty”*, has not yet implemented the decision? And how could one, on the other hand, invoke that an arbitrator was biased (this being certainly one of the most frequently invoked reasons for set-aside procedures in commercial arbitration cases)?<sup>30</sup>

### **III. Evaluation and Outlook**

So far, only a few tax treaties have provided for mandatory arbitration. Some of the prominent examples include article 25 A of the Franco-German Tax Treaty as amended of 28 September 1989<sup>31</sup>, article XIII of the Protocol of 1 June 2006 to the US-German Tax Treaty<sup>32</sup>, or the Multilateral Arbitration Convention of 20 August 1990, concluded between the EU member states<sup>33</sup>.

Compared to the new OECD Model, however, these treaties appear incomplete: the Franco-German and the US-German treaties do not provide for mandatory arbitration whereas, pursuant to article 12.1 of the EU-Convention (which concerns only transfer pricing disputes) the result of the arbitration is not binding<sup>34</sup>.

In this respect, the arbitration provision in the new OECD Model is an important step forward since it **applies to all tax treaty claims**<sup>35</sup> and is **mandatory and binding**. Thereby, an actual **outcome of is guaranteed** and the intolerable length of proceedings is capped.

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<sup>29</sup> N° 39 of the Commentary to the Annex.

<sup>30</sup> These questions are discussed by William Park: “Finality and Fairness in Tax Arbitration”, J. Int'l Arb. Vol 11, N° 2 (1994) pp. 19-31.

<sup>31</sup> <http://www.jura.uni-sb.de/BIJUS/doppelsteuer/fr.htm> .

<sup>32</sup> <http://www.ustreas.gov/press/releases/reports/germanprotocol06.pdf> .

<sup>33</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:41990A0436:EN:HTML> .

<sup>34</sup> The result of the arbitration is only binding unless the competent authorities concurrently “take a decision which deviates from the advisory commission's opinion” (article 12.1).

<sup>35</sup> The new paragraph 5 refers to cases “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”.

One can congratulate the OECD that it has achieved consensus among all its members on such a sovereignty-sensitive subject as arbitration of tax disputes. The fact that the subject has been discussed among tax lawyers several decades and that the OECD initiative took more than three years of continuous work illustrates the great effort undertaken in order to succeed.

Nevertheless, there is still **room for improvement**:

While it is true that the proposed arbitration can guarantee an outcome to mutual agreement procedures, a reached mutual agreement can well turn out to be nothing more than a minimal consensus or “lowest common denominator”. The taxpayer has no means to force the states to reach an **outcome in accordance with the respective treaty** since the arbitration provision neither is suitable to put an end to the long criticised practice of “**horse-trading**” between competent authorities nor does the taxpayer obtain the right to significantly **participate** in or exert influence on the procedure.

Of course, this could be justified by the fact that the taxed enterprise, formally, is not a party to the arbitration. But this very fact, in turn, implies that the outcome is not binding on the taxed enterprise. Thus, it can reject the outcome and go to court to have its case heard there. In conclusion, the new arbitration provision has not eliminated the risk of **doubled procedures**.

An alternative approach would be to give the taxpayer a “true” recourse against the (double-) taxing states. By way of a “true” tax treaty arbitration, the taxpayer would be vested with procedural and substantive rights conferring him the possibility to secure a solution in accordance with the treaty. This would, in fact, correspond much better to the needs of cross-border business activities. Such an approach would not only be favourable from an economic point of view (legal certainty and investment protection); it would also avoid the waste of time and resources caused by lengthy and doubled procedures. Following this approach, the International Chamber of Commerce has issued a policy statement in 2002 containing a draft arbitration agreement for implementation<sup>36</sup>.

Of course, it was the tax sovereignty argument that prevented the OECD States to envisage this alternative solution. But given the latest developments in investment law where taxation matters are increasingly submitted to arbitration, one might ask if the tax sovereignty argument sounds very convincing any longer.

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<sup>36</sup> ICC Policy Statement of 6 February 2002: <http://www.iccwbo.org/policy/taxation/id501/index.html> .

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