GUEST EDITORIAL

Types of Arbitration Procedure

1 Introduction

In any question of disputed interpretation of a treaty one or other party is right and there is no possibility of a middle way. At first sight transfer pricing, which is likely to be the largest issue for arbitration, seems to be different where the arbitration panel might need to fix a price somewhere in the middle. I doubt this. Everyone accepts that transfer pricing has a possible range within which both parties are right. Clearly nobody is going to arbitrate within this area. Outside this possible range there must be a reason of principle why the parties differ. The arbitration can decide which of them is right and there is again no possible middle way, at least in the majority of cases.[1] The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI)[2] envisages that the 'final offer' process (which everyone calls 'baseball,' and I shall do the same) can apply to cases other than where each party can specify its contention as a monetary amount. It provides for baseball arbitration to apply to 'threshold questions' about whether a particular treaty provision applies, such as whether there is a permanent establishment, or where an individual is resident.[3] Baseball arbitration is particularly suited to this type of case as there is no possible middle way. My impression of domestic law appeals in cases other than treaties is that decisions on a middle way arises in only a small proportion of cases, and I think it would be the same for treaty disputes.

The other preliminary point is the huge number of mutual agreement procedure cases for which arbitration may be suitable. The latest OECD statistics are for 2017[4]:

All cases	*2017 Start inventory*	*Cases started in 2017*	*Cases closed*	*End inventory*
Cases received prior to 1 January 2016 or of the year of joining the BEPS Inclusive Framework	6313	0	1764	4549
Cases received on or after 1 January 2016 or of the year of joining the BEPS Inclusive Framework	1187	2076	981	2282

This is not to suggest that we are likely to end up with that number of arbitrations even if all states agreed to the MLI arbitration provision. Indeed, the ideal arbitration provision is one that would encourage settlement of these.

2 Arbitration processes under the MLI

The MLI puts forward two possible 'processes' (I shall follow their terminology so as to leave 'procedure' to mean the detailed procedure in conducting the arbitration): the default baseball ('final offer'), and 'independent opinion.' The essential difference between them is that under the former the arbitrators have to choose between

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1 One can envisage cases where there is more than one point of principle involved with each party winning a different point. I do not think that the MLI baseball provision caters for this but, since the rules apply '[e]xcept to the extent that the competent authorities of the Contracting Jurisdictions mutually agree on different rules' (MLI Art. 23(1) and (2)), the parties can agree on a sensible result.

2 OECD, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (OECD Publishing 24 Nov. 2016).

3 MLI Art. 23(1)(a). The US procedures described below also deal with this but envisage that both the threshold question and the figures will be dealt with at the same time, the latter being in a sealed envelope until the former is decided. I would suggest it is preferable to separate these rather than having to deal with figures which may never arise.

4 *See* OECD, *Mutual Agreement Procedure Statistics for 2017*, http://www.oecd.org/tax/dispute/mutual-agreement-procedure-statistics.htm (accessed 12 Mar. 2019) which also includes information for each jurisdiction. Of the 'end inventory' 54% are transfer pricing cases.

INTERTAX, Volume 47, Issue 8 & 9

the position of one or other parties. This can be a monetary amount, as would be normal in a transfer pricing dispute, or a threshold question, such as whether there is a permanent establishment, about which there is no possible middle way anyway. Under independent opinion the arbitrators are not limited to choosing the position of one or other party but can come to a decision somewhere in between.

Unfortunately the MLI has mixed this up with whether reasons are given, which is a completely different issue, by forbidding reasons in a baseball arbitration. It may be that in arbitrations for the remuneration of baseball players, which is where the term originates, it would not be possible to give reasons, and it may be that tax arbitrators in the US are reluctant to give reasons for fear of being sued. Unfortunately the US has influenced the MLI in this respect, and then failed to sign the MLI, which means that the rest of us are left in an unsatisfactory position. It does not follow that reasons cannot in principle be given in tax treaty baseball arbitrations. After all, as already explained, even transfer pricing disputes are likely to involve a point of principle, and a threshold question on interpretation (under which there is no possible middle way and it is therefore ideally suited to baseball arbitration) would lend itself to giving reasons, which in some cases such as the existence of a permanent establishment or whether someone was the beneficial owner could involve quite complex reasons. In addition, I am sure the parties would prefer to be given reasons, particularly so when they are tax authorities likely to have similar issues in the future. Indeed I have had experience of a losing tax authority saying this and there was nothing I could do about it given the rules under which we were operating. If arbitration decisions were published, as in my view they should be, the public might also benefit from the reasons[5]; and arbitrators would prefer to give their reasons because obviously they have reasons. But the MLI prohibits giving reasons, unless you choose independent opinion. However, the separation of baseball and independent opinion is not quite what it appears at first sight.

The MLI, having set out the two alternatives of baseball or independent opinion and set out some complex provisions about the effect of parties making different choices,which I will not go into as they are dealt with in Natalie Bravo's article, then proceeds to negate the differences because both processes apply '[e]xcept to the extent that the competent authorities of the Contracting Jurisdictions mutually agree on different rules.'[6] They could have saved themselves a lot of trouble by having one arbitration process and leaving it to states to agree on the type of process suited to the particular dispute. If the MLI wanted to have two separate processes and an exception to allow for variations, it would have been much better to have been more specific about all details. I am not a believer in the MLI being even longer but in this case it is much easier to provide a framework which parties can change by agreement than to leave everything to agreement, giving rise to the possibility that they cannot agree and there is no default. For example, the baseball alternative could have set out the time scale and the limits on the size of the parties' written contentions and reply, which would be one less matter to be agreed, while still leaving open the possibility of agreeing something else to suit the circumstances. It will be seen below that the US have managed to agree similar terms about time limits and length of submissions with four countries, suggesting that if the MLI had tried to specify this, other countries might have agreed, particularly when there was always the possibility of agreeing something different in a particular case. It may be that the proposed model competent authority agreement pursuant to article 19(10) will help but it does not alter the fact that there is no default provision if the parties cannot agree. I am unpersuaded by the Explanatory Statement's justification for its reliance on mutual agreements to settle the details: '[i]n recognition of the wide variety of legal and tax systems, and the fact that each competent authority relationship is unique.'[7] If that were so it is surprising that the US seems to have managed to agree similar default provisions with four countries with differing legal systems, one common law and three civil law (and surely all tax systems are different anyway).

It follows that it is possible under the MLI to achieve what I consider to be the best of both worlds: baseball arbitration with reasons. If both parties have allowed the default baseball arbitration to apply, the default rules that prevent reasons being given apply '[e]xcept to the extent that the competent authorities of the Contracting Jurisdictions mutually agree on different rules.'[8] There is nothing to prevent them from agreeing in a particular case[9] that the arbitrators should give their reasons. They can agree on article 23(2)(c) applying, which is a rule applicable to the independent opinion process:

> The arbitration decision shall be delivered to the competent authorities of the Contracting Jurisdictions in writing and shall indicate the sources of law relied upon and the reasoning which led to its result. The

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5 This is quite different from saying that they would constitute a precedent.

6 MLI Art. 23(1) and (2).

7 OECD, *Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* 229 (OECD Publishing, 24 Nov. 2016).

8 MLI Art. 23(1).

9 This is confirmed by the Explanatory Statement, *supra* n. 7, at 241.

arbitration decision shall be adopted by a simple majority of the panel members. The arbitration decision shall have no precedential value.

If the parties have made different choices about the process (including one of them allowing the default baseball option to apply by default and the other choosing independent opinion) then independent opinion applies.[10] In the same way, the parties can still agree to the baseball rule that the arbitrators cannot choose a middle way. The independent opinion rules apply subject to the same exception already quoted that the parties can mutually agree on different rules in a particular case.[11] They can therefore agree on the application of some of the wording taken from the baseball provisions.

3 Procedural rules

So far as procedural reasons are concerned the ideal from the arbitrators' point of view is that the fewer the better. Arbitration is intended to be a quick procedure to deal with the huge numbers of mutual agreement procedure cases. If you trust the arbitrators to decide the issue it should follow that you should trust them to adopt a procedure that will give both sides (and indeed the taxpayer) a fair hearing. I can give you my experience of the disadvantage of prescriptive rules which arose in a private tax-related arbitration under the London Court of International Arbitration rules, one of which is that if one side requests an oral hearing they were entitled to have one. In the particular arbitration at the end of the written submissions the arbitrators conferred and found that they were unanimous in thinking that Party A was right. Party A, presumably thinking they would lose on the basis of the written submissions, then requested an oral hearing. The arbitrators knew that this was not in their interests but could not say so because they had not made a decision, and indeed could not do so if there was to be an oral hearing, but had merely sounded out their views between them. The cost of an oral hearing would have been enormous in travel and hotel bills, to say nothing of professional costs. The arbitration would have taken place in London. Neither party nor their representatives was in the UK, and only one of the three arbitrators was in the UK (and he did not live in London). Fortunately in the circumstances the request lapsed because Party A had failed to comply with something else. But I hope this helps to show that rules are not necessarily in everyone's interests. I therefore favour minimalist rules dealing with the minimum items such as time limits for written submissions.

Much has been written about the need for taxpayer involvement in the arbitration process. I believe that this is self-policing. Arbitrators come with a fresh eye to a dispute that has been running between the Competent Authorities for two years. When the arbitrators look at the case either they will consider whether they have all the facts they need, or whether they will see the need for more facts, in which case they will ask the taxpayer who will be delighted to provide them to assist its case. I doubt if there is any need to build in a right for the taxpayer to be heard.

There is a good precedent for minimalist rules which the US uses for baseball arbitration in its treaties with Canada, Germany, France and Belgium, which are on the IRS website.[12] I shall concentrate on the documents relating to Canada where it is known that there have been some arbitrations and so both countries have tried them out and found them successful otherwise they would have already changed them. In summary, each competent authority appoints an arbitrator and together they appoint a chair from a previously agreed list. Within sixty days each competent authority presents a position paper of not more than thirty pages (plus annexes) and a proposed resolution article of not more than five pages. Within a further sixty days each competent authority presents a reply of not more than ten pages. No additional information is permitted but the Chair can request further documents (but not analysis). The arbitrators can adopt any additional procedures so long as they do not conflict with the treaty. The arbitrators are not expected to meet (although this is possible) but to reach a decision on the telephone or video conferencing. Each arbitrator chooses the position of one or other competent authority and the decision is made by a majority vote.

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[10] MLI Art. 23(2) and Explanatory Statement, *supra* n. 7, at 248.

[11] This is confirmed by the Explanatory Statement, *supra* n. 7, at 245.

[12] US: IRS, *Mandatory Arbitration with Germany, Belgium, Canada, and France*, https://www.irs.gov/businesses/international-businesses/mandatory-arbitration-with-germany-belgium-and-canada (accessed 12 Mar. 2019). Some of the links on this IRS website result in 'page not found.' The correct URLs are: US: IRS, *Canada – Memorandum of Understanding Between the Competent Authorities of Canada and the United States of America*, https://www.irs.gov/pub/irs-utl/2010_arbitration_mou_nov_8-10_-_final.pdf (accessed 12 Mar. 2019); US: IRS, *Canada – Arbitration Board Operating Guidelines,* https://www.irs.gov/pub/irs-utl/2010_-_arbitration_-_board_operating_guidelines_nov_8-10_final.pdf (accessed 12 Mar. 2019); US: IRS, *Germany – Memorandum of Understanding Between the Competent Authorities of the Federal Republic of Germany and the United States of America,* https://www.irs.gov/businesses/corporations/memorandum-of-understanding-between-the-competent-authorities-of-the-federal-republic-of-germany-and-the-united-states-of-america (accessed 12 Mar. 2019), (I have not been able to find the operating guidelines on the website); US: IRS, *Belgium – Memorandum of Understanding Between the Competent Authorities of the Kingdom of Belgium and the United States of America,* https://www.irs.gov/businesses/international-businesses/memorandum-of-understanding-between-the-competent-authorities-of-the-kingdom-of-belgium-and-the-united-states-of-america (accessed 12 Mar. 2019), US: IRS, *Belgium – Arbitration Board Operating Guidelines*, https://www.irs.gov/businesses/international-businesses/arbitration-board-operating-guidelines-us-and-belgium (accessed 12. Mar 2019); US: IRS, *France – United States-France Arbitration Board Operating Guidelines*, https://www.irs.gov/businesses/international-businesses/united-states-france-arbitration-board-operating-guidelines (accessed 12 Mar. 2019); IRS, *France – United States-France Competent Authority Memorandum of Understanding*, https://www.irs.gov/businesses/international-businesses/united-states-france-competent-authority-memorandum-of-understanding (accessed 12 Mar. 2019).

It will be seen that this is a quick and easy solution that is ideally suited to determining the large number of MAP cases, or more probably forcing them to settle as I believe happened between the US and Canada when this procedure was first adopted. The fees are modest; I believe it is USD 2,000 to 3,000 (the latter being the International Centre for Settlement of Investment Disputes figure) per day for each of the arbitrators. It is not expected that more than three days preparation will be involved and if the decision is made by telephone or video conferencing this is likely to be included in that time limit.

The MLI would permit exactly this procedure, and as I have suggested with the addition of reasons being given if the competent authorities agreed to it. The MLI could have included the time limits and limits on the length of submissions which could have been varied by agreement. This would have saved the competent authorities from having to agree them.

I have one procedural suggestion which is that the competent authorities should not attempt to administer their own procedure. Competent authorities have many fine qualities when administering tax systems but experience of administering arbitrations is not one of them. Suppose that one state is in default over time limits for appointing the arbitrators, it is obviously inappropriate that they have to agree on the consequences, and other circumstances can arise during the arbitration that a third party would resolve more easily than the parties or the arbitrators. It would be much better to appoint a third party like the Permanent Court of Arbitration in the Hague or TRIBUTE, see the article by Hans Mooij.

The MLI fails by trying to reinvent the wheel, when the wheel has been satisfactorily invented by the US and shown to work in practice. Arbitration arises because competent authorities cannot agree on the big question; it should not be a requirement that before they start they have to agree a lot of little questions. What is required in designing an arbitration procedure is not a perfect system but a quick and easy procedure, so that the competent authorities when failing to agree say to themselves: if we do not agree it will be settled easily by arbitration under which we might lose, and so we might as well agree.

If some MLI states which have agreed to the arbitration provision were to try this out I believe that its success would soon encourage the other states to adopt it. It would also be a great advance on the European procedure which includes the competent authorities – who are clearly not independent[13] – on the arbitration panel. However, it is good that arbitration without their presence on the panel could be adopted using article 10 of Council Directive (EU) 2017/1852.[14]

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[13] There may have been nothing that could be done to prevent this when the procedure was governed by a convention, but I doubt if the CJEU will allow it in the Directive. As the Court said in a VAT case, emphasising the independence of arbitrators: 'Whilst arbitrators are in fact often chosen amongst lawyers by reason of their legal knowledge, the services provided by a lawyer are none the less principally and habitually those of representing or defending the interests of a person, whereas the services of an arbitrator are principally and habitually those of settling a dispute between two or more parties, even though this is done on an equitable basis.' *See* DE: CJEU 16 Sept. 1997, Case C-145/96 *Hoffmann v. Finanzamt Trier*, ECLI:EU:C:1997:406, at 17.

[14] Council Directive (EU) 2017/1852 of 10 Oct. 2017 on tax dispute resolution mechanisms in the European Union, OJ L 265/1 (14 Oct. 2017).