Time for Arbitration in International Taxation

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Two recent events on the international tax scene prove that time has come for a radical change in international tax law. On 27 July 2004 the OECD released its Draft Progress Report 'Improving the Process for Resolving International Tax Disputes', suggesting arbitration as a supplementary mechanism for the settlement of tax treaty disputes.¹ One week later, the EU Member States completed the ratification of the Protocol extending indefinitely the EU Multilateral Arbitration Convention on Transfer Pricing, with binding effects as of 1 November 2004.²

Both regard arbitration as a tool to improve effectively the settlement of cross-border tax disputes. Furthermore, eminent international tax scholars have supported arbitration throughout the past decades and various bilateral tax treaties now include arbitration clauses, which allow for effective solutions to cross-border disputes in reasonable time and with binding effects for both tax administrations and the taxpayer(s).

The consensus on the use of arbitration in international tax is now broad enough to predict that the nature of cross-border tax relations and the structure of international tax law will significantly change in the years to come. Should the taxpayer beget an effective treaty protection as to taxes being levied by both Contracting States in accordance with the Convention, then international tax law would enforce this without dependency on domestic law and evolve towards a separate legal order. It would give effective rights to persons and no longer be merely a matter of settling disputes on the distribution of taxing powers between states. Nevertheless, this evolution is still ahead of us, somewhere on the horizon.

Meanwhile, the tax community shall have to address a number of critical issues raised by the OECD Draft Progress Report and the EU Arbitration Convention. Following the methodology often used by the OECD in the past decade, the Draft Progress Report supports the requirement of mandatory submission of unresolved MAP disputes to arbitration by amending the Commentary, rather than the Model itself. This technique has often been used by the OECD through-

out the past decade for the purpose of interpreting the Model rather than amending it, thus affecting the existing bilateral treaties. Changes (or additions) to paras. 46 and 47 of the Commentary on Art. 25 of the OECD Model Convention would thus allow consideration of arbitration as an additional instrument for tax authorities to 'endeavour ... to resolve the case'. One wonders whether the proposed solution will solve more problems than it raises. Mandatory submission to arbitration is certainly better than the current procedures applicable under Art. 25 of the OECD Model Convention, but it is not the right answer to cross-border tax disputes, which require effective solutions to effective problems, i.e. mandatory resolution. Rightly, it is submitted, the Draft Progress Report acknowledges that mandatory resolution may not fall under the scope of the obligation 'to endeavour', set by the wording of Art. 25 of the OECD Model Convention. Likewise, should mandatory submission require changes to the Model, rather than to its Commentary? Substantial changes to the scope of the clauses of the Treaty should not be disguised as issues of interpretation, but undergo the process that departs from an amendment to the Model (through Art. 25A, as suggested by some scholars) and passes through corresponding new clauses into bilateral tax treaties. Without such process, supplementary dispute resolution will raise substantial litigation in a context that does not allow a sufficient degree of taxpayer's protection and so be unfair.

Some kind of mandatory resolution is already ensured by the EU Arbitration Convention, which will have to address other issues, including those raised by its application to procedures between 2000 and 1 November 2004, domestic appeals, its legal status and relation to primary Community law. The ECJ, I believe, will not wait long before addressing issues that may affect fundamental freedoms.

Time for arbitration in international taxation has come, but why not for an International Tax Court?

The step would not be a big one and, after all, international tax law and the taxpayer's protection would highly benefit from such an evolution.

Notes

¹ The final version of the document is to be released on 7 December 2004.

² Also see http://europa.eu.int/comm/taxation_customs/taxation/company_tax/docs/forum9/Protocol_AC.pdf for an EU Commission discussion paper, drafted for the EU Joint Transfer Pricing Forum held on 16 September 2004.