Litigating EU Tax Law in International, National and Non-EU National Courts

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Why this book?
As EU tax law has become more and more complex and sophisticated in recent years, so has EU tax law litigation. The features of EU law and its own sources give rise to specific problems when litigating EU tax law not only before the Court of Justice of the European Union (ECJ) but also before EU national courts. Additionally, the relevance of EU tax law has expanded outside the EU borders, inspiring tax litigation before national courts of non-EU states as well as before international courts.

This book is the result of the 7th GREIT Conference held in September 2012 in Madrid at the Instituto de Empresa (IE). The book analyses the problems and challenges faced by taxpayers when litigating EU tax law from a comparative perspective, dealing not only with purely national issues but also with the influence of EU tax law in tax litigation in international scenarios.

The book is divided into four main parts. The first part focuses on EU tax law litigation before the ECJ, analysing the functioning of the litigation services of the European Commission and the remedies and procedures when dealing with infringements from the Member States. In the second part the position of EU national courts when applying EU tax law is examined comparing the approach followed by courts of four EU jurisdictions. Part three deals with the influence of EU tax law in litigation before international courts and in international arbitration. Finally, part four looks at the approach followed by non-EU national courts when applying and interpreting EU tax law.

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Table of contents

Sample chapter

A Game of Snakes and Ladders – Tax Arbitration in an International and EU Setting

David Ramos Muñoz[1]

7.1. Introduction

There is an apocryphal anecdote of Mahatma Ghandi, where he was asked what he thought about Western civilization, and he answered: “Yes, I think that would be a very good idea”. One is tempted to give the same answer when asked about tax arbitration. For it would seem to be conventional wisdom that arbitration has not yet reached the tax field, and that any response to the question would have the contours of a hypothetical and speculative exercise.

To be entirely fair with states and tax authorities, they have engaged in an honest effort to expand the availability of dispute resolution mechanisms beyond ordinary administrative or judicial processes. Isolated examples of such mechanisms were already present in the 1990s and 2000s in the Germany-Sweden and Germany-Austria treaties;[2] as well as in the Euro-

1. The author wishes to thank Professor Violeta Ruiz Almendral for her very useful comments in an earlier draft of this chapter, and the members of the GREIT group for their excellent presentations, which helped me familiarize with the purely tax issues that arbitration was supposed to help resolve. I am especially grateful to Daniel Sarmiento, for his comments on the ECJ view on EU law issues, Peter Wattel, for his remarks on procedural guarantees concerning rights of access to justice and property, and Adolfo Martín Jiménez, for the background on the OECD Model reforms. Last, but not least, this chapter greatly benefitted from the linguistic editing by Eleanor Campbell, who struggled to make its prose more digestible. Any mistakes and inaccuracies remain the sole responsibility of the author.

2. *See* Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital, 24 August 2000, Austria-Federal Republic of Germany, 2001 WTD 36-15; Convention for the Avoidance of Double Taxation on Income and Capital, Sweden-Federal Republic of Germany, 1995. Other treaties provided for the possibility of resorting to arbitration if the tax authorities consented to it. Article 25(5) of the former 1991 treaty between the United States and Germany stipulated that “If a disagreement cannot be resolved by the competent authorities it may, if both competent authorities agree, be submitted for arbitration” (thereby requiring ad hoc consent in each case, rather than establishing an automatic right to begin arbitral proceedings). *See* William W. Park, *Income Tax Treaty Arbitration*, George Mason Law Review, vol. 10 (2002), at 803-804 and 811-812.

pean "Arbitration" Convention (which should be more accurately called the "Transfer Pricing Convention").[3] The idea seems, however, to have received a new impetus with the inclusion of an "arbitral" mechanism in the Model Tax Conventions of the Organisation for Economic Co-operation and Development (OECD)[4] and the United Nations (UN),[5] as well as in the modified bilateral tax treaties between the United States, on one side, and Belgium,[6] Germany,[7] Canada[8] and France,[9] on the other. With the "arbitral" solution being supported by the international community, and actively promoted as part of their tax treaty policy by the United States and Germany (at least), "tax arbitration" seems a reality; so, are the inverted commas, and the skepticism they convey, justified at all?

The answer is that even if "tax arbitration", as an issue, deserves more than a condescending smile and a frown of disbelief, even if the effort made by states and international organizations is undeniable, whether such efforts have been enough to establish full-blown arbitral proceedings is still a legitimate question, and still an inconvenient one.

It is still legitimate because states, even when accepting the introduction of arbitration as a positive move, have fought hard to give themselves extra room for manoeuvre. In that regard, the abovementioned instruments include important variations that clearly depart from "conventional" commercial or investment arbitration.

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3. Article 7 of the European Convention 90/463/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises. The Prolongation Protocol entered into force on 1 November 2004, 3 months after all Member States had ratified it. Article 3.2 states that it took effect from 1 January 2000 and thus provided for a retroactive application of the Arbitration Convention.
4. Art. 25(5) OECD Model Tax Convention on Income and on Capital, 2010.
5. Art. 25 (alternative B), para. 5 United Nations Model Double Taxation Convention between Developed and Developing Countries, New York, 2011.
6. Convention between the Government of the United States of America and the Government of the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, 27 Nov. 2006 (hereinafter "US-Belgium Convention").
7. Protocol Amending the Convention between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, 1 June 2006 (hereinafter "US-Germany Protocol").
8. Protocol Amending the Convention between the United States of America and Canada with Respect to Taxes on Income and on Capital, 21 Sept. 2007 (hereinafter "US-Canada Protocol").
9. Protocol Amending the Convention between the Government of the United States of America and the Government of the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, 13 Jan. 2009 (hereinafter "US-France Protocol").

It is inconvenient because such variations have an influence on the aspects that are considered essential to classify a dispute resolution process as an "arbitration" mechanism. Rather than being a matter of semantics, concluding that something is "arbitration" or not makes an enormous difference in the protection dispensed by the domestic, and international, legal order.

Section 7.2. of the present study will address such concerns, whereas sections 7.3. and 7.4. will deal more directly with all the aspects of a dispute's resolution, from the moment of the consent to the moment of the decision and its enforcement. The focus will be on examining whether the differences between such mechanisms and those contemplated for commercial and investment arbitration justify a conceptual distinction between "arbitration" and "tax dispute resolution", and whether the distinction, in turn, implies a need for such differences.

Therefore, the present study has a two-pronged approach. On the one hand, it goes into the detail of how the different mechanisms would work in practice, with special emphasis on those that most closely resemble arbitration, and anticipates possible issues, drawing from the experience of commercial and investment arbitration. On the other hand, it does not lose sight of the fact that all the answers are qualified by the acceptance of the procedures as "arbitral" mechanisms. Since this is a big if, the study is practical and existential in equal measure, and it reflects the difficulties of the scholar and practitioner in reconciling the states' conflicting needs.

7.2. Tax arbitration's lack of pedigree: Sheer snobbery or legitimate concern?

One can hardly think about a more incongruous combination with "arbitration" than "tax law". In itself, the reference to "tax arbitration" can look more like a provocation than the definition of a subject matter of analysis, hence the question mark added in the title to this section.

The question is whether a question mark is justified. Granted, there are important legal hurdles to overcome in order to resolve tax matters in arbitration, but regardless of technicalities and academic discussion, the truth is that tax disputes (especially international ones) where the decision is taken by a body of experts that does not form part of the regular system of administration of justice is a reality.[10] Thus, as a first contention, this chapter describes the existing examples where, despite preconceptions, tax issues are decided through "arbitration" (*see* section 7.2.1.). It is only then, with a more reflective perspective, that we go beyond such preconceptions, and explore the legitimate objections to lend credibility to those examples as manifestations of "tax arbitration" (*see* section 7.2.2.).

7.2.1. "Tax issues are not arbitrated"

This could be the obvious response from an arbitral practitioner who is used to combining in his practice, disputes on commercial contracts, construction, corporate, investment or even intellectual property and securities. Tax does not normally come under the radar. But this focus on more developed disciplines is deceptive, because tax *is* the subject matter of discussion in commercial and investment disputes (*see* section 7.2.1.1.), and even in "pure" tax disputes (*see* section 7.2.1.2.).

7.2.1.1. Tax issues in commercial and investment arbitration disputes

If the question guiding the present preliminary stage is whether "tax" is "arbitrated", or "subject to arbitration", the answer is that it depends on what we consider as "subjecting tax to arbitration" and this, in turn, depends on the distinction between an arbitration "case", and an arbitration "issue", or an issue subject to arbitration. If we settle for the latter, any arbitration practitioner will tell us that tax issues are, indeed, subject to arbitration (and hotly contested).[11] In commercial arbitration cases, tax and, more particularly, tax liabilities are a normal source of analysis in cooperation agreements, joint ventures and, especially, M&A cases, where

10. Professor Park likens the situation to that of the parishioner who, when asked by a priest whether he believes in infant baptism, answers "Believe, Father? I have seen it done". William W. Park, *Arbitrability and Tax* in Loukas Mistelis & Stavros Breoulakis (eds.), *Arbitrability: International and Comparative Perspectives*, Kluwer Law International, 2008, at 179.

11. *See* the special number of the *Revue de l'Arbitrage* 2 (2001), and the contributions by Pascal Ancel, *Arbitrage et ordre public fiscal*, at 269-289; Maurice Cozian, *Arbitrage et incidences fiscales des clauses de garantie de passif*, at 289-299; Ibrahim Fadlallah, *Arbitrage international et litiges fiscaux*, at 299-311; Sébastien Manciaux, *Changement de législation fiscal et arbitrage international*, at 311. The latter is more focused on investment arbitration, but the other three focusing on commercial arbitration.

the size of the liability can clearly influence the price-per-share paid in the transaction;[12] hence, the care placed by experts when accomplishing their due diligence, and the potential source of conflict if expert reports disagree (as they are bound to do when commissioned by both buyer and seller).

Commercial arbitration disputes, of course, cannot alter the nature and amount of the tax liability of the taxpayer vis-à-vis the tax authorities; not only as a matter of the authorities' mandates under public law, but as a matter of the scope of the consent to arbitrate. Even if two parties have explicitly agreed on the amount of tax liability to be satisfied by each of them (for example, by means of an indemnity for tax amounts),[13] such agreements are not binding on the tax authorities, nor is the arbitration clause that may accompany them.

But if we move outside commercial arbitration disputes, it is not difficult to see that the subject matter of the dispute may not be the private party's tax liability, but the legitimacy of the tax itself. In investment arbitration disputes it has not been infrequent for defendant states to have passed tax measures in breach of some of the state's duties under the terms of an investment treaty, where it has committed itself to protect the investment transactions in its territory undertaken by nationals of the other contracting state. In such cases, where the subject matter of the treaty violation under the investor's claim is the state's taxation measures, one could argue that tax has ceased to be "an issue", and has become a "case". Examples of arbitration disputes where state taxation measures were subject to scrutiny under investment treaties, are abundant,[14] and will increase in importance as governments, rebuffed in expropriation cases, resort to more indirect measures, consisting of regulatory and tax changes.

7.2.1.2. Tax issues in tax disputes

Outside the commercial and investment arbitration circuit, tax issues are also discussed (and resolved) in out-of-court settings, in "proper" tax dis-

12. Maurice Cozian, *supra* n. 11, at 289-299.
13. This type of clause has so far been the main focus of analysis by contribution on the subject of "tax and arbitration". *See* Maurice Cozian, *supra* n. 11, at 289-299; Pascal Ancel, *supra* n. 11, at 269-289.
14. They include *Tokios Tokeles v. Ukraine*; *Plama Consortium v. Bulgaria*; *Chevron Texaco v. Ecuador*; *Pan American Energy v. Argentina*; *Occidental v. Ecuador*; *Nykomb Synergetics v. Latvia*; *Goetz v. Burundi*; *Feldman v. Burundi*; *Duke Energy v. Peru*; *Corn v. Mexico*; *Continental Casualty v. Argentina*; *Cargill v. Mexico*; *Archer Daniels v. Mexico*; *Amto LLc v. Ukraine*, and many others.

putes. In such disputes it is not the incidence of the tax rule and the tax liability arising from it, that are discussed. It is rather the determination of the tax liability that constitutes the subject matter of the dispute.

In fact, it was arbitration that seemed to have support as the mechanism of resolving international tax disputes in the 1920s and 1930s, when arbitration provisions were included in treaties between Ireland and the United Kingdom (1926) or Czechoslovakia and Romania.[15] It was only in the 1960s when, after efforts to establish such mechanisms seemed to have stalled, the OECD gave them another push. On the understanding that member countries were not prepared to relinquish sovereignty as an arbitral mechanism requires, it did so by introducing into its Model Treaty the mutual agreement procedure (MAP) which, as its name indicates, consists of a negotiation procedure between the competent authorities (CAs). It was only later (in the 1980s) that mechanisms involving the opinion of a third party (rather than relying on negotiation only) were re-introduced in individual (i.e. not "Model") bilateral tax treaties (BTTs) as a result of the support given to them by countries such as Germany or the United States.[16]

Then, alternative dispute resolution mechanisms started to develop as an actual possibility, hailed not only by single states, but also by the community of nations with sophisticated tax systems, albeit through a restriction of the scope of the disputes from the generality of "cross-border taxation", or even "double taxation" cases, to the more specific field of transfer pricing disputes. The reason for this is that, in such disputes, given the complexity of industry (and services) processes, the methods for determining transfer prices between entities of a single group became an incredibly cumbersome issue and one which increasingly required the constructive engagement of both taxpayer and tax authorities. Moreover, even if the success and widespread use of the so-called advanced price agreements (APAs) is well-known, the contested nature of the problem, with minor adjustments resulting in a changes of millions in the monetary value of tax liabilities, and the involvement of several tax authorities with diverging interests, began to require the use of independent and impartial third parties in such "agreements", thereby turning the final outcome into something

15. Czechoslovakia-Romania double taxation convention of 20 June 1934. A board was formed by the Fiscal Committee of the League of Nations.

16. *See* Sharon A. Reece, *Arbitration in Income Tax Treaties: 'To Be or Not To Be'*, Florida Journal of International Law, vol. 7 (1992) at 288 and 289, referring to the treaties between the United States and Germany, the United States and Mexico, and the United States and the Netherlands.

that, at first glance, resembled an arbitral mechanism.[17] The EU Arbitration Convention (which should be called the Transfer Pricing Convention) is a result of the acknowledgement by states of this necessity.[18]

It is only after such a long process that arbitration has been re-introduced as a more "general" mechanism of dispute resolution for all kinds of international tax disputes: first, in the Model Tax Convention of the OECD, in paragraph 5 of article 25, which otherwise regulates the MAP,[19] and thereafter, by means of Protocols to the BTTs between the United States and Belgium,[20] the United States and Germany,[21] the United States and Canada,[22] the United States and France,[23] or the United States and Spain,[24]

17. In the United States, for example, some famous transfer pricing disputes have been resolved by means of arbitral courts/boards/panels. *See*, for example, Stipulation for Resolution through Voluntary Binding Arbitration under Tax Rule 124, *Apple Computer Inc. v. Commissioner*, no. 21781-90 (T.C. 1993). In the case the arbitral board indicated that, applying the proper transfer prices between entities of the same group, an important amount of the taxable income/base had to be re-assigned to the United States, rather than Singapore. *See* William W. Park, *supra* n. 2, at 824-825.

18. Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, 90/463/EEC, OJ L225/10, 20.8.90.

19. The reasons to include arbitration in tax treaties relate to the shortcomings of the MAP (lack of a requirement to achieve a solution, excessive duration, lack of transparency, and limited intervention by the taxpayer) and the evolution of the context of disputes and policy views (increase, in number and importance, of transfer pricing disputes, ratification of the European Convention in 1995, the evolution of the United States' position, and the inclusion of the issue in the Fiscal Affairs Committee of the OECD). *See* Adolfo J. Martín Jiménez, *Chapter V.2. Procedimiento Amistoso*, in Carmen Fernández (coord.) *Convenios Fiscales Internacionales y Fiscalidad de la UE*, CISS, 2012, at 6.2.

20. Convention between the Government of the United States of America and the Government of the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, 27 Nov. 2006 (hereinafter "US-Belgium Convention").

21. Protocol Amending the Convention between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, 1 June 2006 (hereinafter "US-Germany Protocol").

22. Protocol Amending the Convention between the United States of America and Canada with Respect to Taxes on Income and on Capital, 21 Sept. 2007 (hereinafter "US-Canada Protocol").

23. Protocol Amending the Convention between the Government of the United States of America and the Government of the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, 13 Jan. 2009 (hereinafter "US-France Protocol").

24. Protocol Amending the Convention between the Government of the United States of America and the Kingdom of Spain for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, 14 Jan. 2013.

a number that is bound to increase as arbitration makes its way to the top of the US and German (as well as Austrian or Dutch) policy agenda vis-à-vis BTTs.[25] All these facts militate against the idea that arbitration and tax are mutually exclusive, and find no common ground, or do they?

7.2.2. "Tax arbitration is not arbitration"

One would be tempted to answer the above question with an unqualified "yes" answer, were it not for the fact that the re-discovered pro-arbitration zeal in some states masks a more complex reality, where states (and their tax authorities) wish to have the benefits of arbitration without giving up the privileges of their sovereign status. This leads us to answer with a cautious "it depends", and to elaborate on this idea by stating that it depends on what we understand for arbitration.

With it being such a developed field, one might be tempted to conclude that the idea of "arbitration", as that of "beauty", is in the eye of the beholder. Fortunately for us, academic treatises attempting to define the term tend to be fairly coincident on most of its features. First, arbitration constitutes an "*alternative*" dispute resolution mechanism, as opposed to the jurisdiction of normal courts. As opposed to courts, which are constituted, and remain in place to decide on a range of cases determined by abstract rules, arbitral tribunals are constituted for one specific dispute, and dissolved once the dispute has been resolved.[26] Second, arbitration is a "*private*" mechanism, which is selected and controlled by the parties to the dispute.[27] The arbitrators may be empowered to decide on the outcome of the dispute, and the procedure to be followed until a conclusion is reached, but such power stems from a voluntary act by the parties; an element that manifests itself in the ability of the parties to control the proceedings, provided they act together by agreement.[28] Such action by the parties has a clear goal: to resolve the dispute, which gives us the final characteristic of arbitration because, for the purpose of resolving the dispute, arbitrators are empowered to make a determination of the parties' rights and obligations that is "*final and binding*".

25. Arbitration has found its way into more improbable places, such as article 25(5) of the Spain-Switzerland treaty, added by the Protocol of 27 July 2011.
26. Julian Lew, Loukas Mistelis & Stefan Kröll, *Comparative International Commercial Arbitration*, Kluwer Law International, 2003, at 4.
27. Id.
28. Id.

Greater insight will be gained, in order to classify alternative mechanisms for resolving tax disputes, if, besides defining what arbitration "is", we contrast this with what arbitration "is not". First of all, arbitration is *not* a mechanism relying on the decision of regular courts. Submitting a dispute to one of such courts may have some of the elements of arbitration such as "consent", but the "alternative" element is missing. Also, it is questionable whether and to what extent such a court can act as the parties' "private" court, and thereby be asked to consider not only the issues, but also the legal sources, indicated by the parties, and pursuant to the procedural rules agreed upon by them. Courts are typically not that malleable. Therefore examples of "voluntary jurisdiction", such as the submission of disputes to the International Court of Justice (ICJ) in the Germany-Sweden tax treaty,[29] or to the European Court of Justice, in the one between Germany and Austria,[30] cannot be considered examples of "arbitration".

Nor can the examples of what is generically called "third-party determination" be considered to be arbitration. In the private arena, this encompasses situations where, for example, an expert is called to decide on a contentious issue of *fact* between the parties, such as the quality of goods in a commodities contract, or of the works performed (a matter typically decided by an engineer), under a construction contract.[31] Some complex contracts may stretch the idea, and provide for middle-of-the-road solutions, such as the so-called "adjudication" in construction contracts, where a person (or, more generally, a "board") decides on the parties' dispute, as a matter of expediency, a "dispute" that, given the lack of specificity of construction contracts in that regard, can be legal as well as factual.[32]

The description of the task entrusted to experts and adjudicators can well fit the description of some mechanisms of alternative resolution typical in tax cases, such as those designed for some types of factual issues (typical in disputes over prices), both under the domestic law of some states[33] or

29. Article 41(5) of the German-Swedish tax treaty, which applied parts of the European Convention for the Peaceful Settlement of Disputes, such as chapters I (jurisdiction of the ICJ), or II (conciliation), but not III (arbitration). However, it provided that, instead of such proceedings, the parties could agree on a court of arbitration whose decision would be binding on them.

30. Art. 25(5) Germany-Austria double taxation convention.

31. Andrew Tweddale & Keren Tweddale, *Arbitration of Commercial Disputes*, Oxford University Press, 2005, at 10 et seq. *See also* Julian Lew, Loukas Mistelis & Stefan Kröll, *supra* n. 26, at 10-12.

32. Andrew Tweddale & Keren Tweddale, *supra* n. 31, at 15-17.

33. *See* IRS Rev. Proc. 2006-44 *Appeals Arbitration Program*, Internal Revenue Bulletin: 2006-44, 30 Oct. 2006; with regard to IRM 8.26.6 and 35.5.5.1-35.5.5.3; and

international, as the one contemplated under the EC Convention, which deals primarily with matters of *determination* of transfer prices, i.e. disputes of *fact*.[34]

Finally, arbitration is not one of the mechanisms that requires the parties' agreement for a solution to be reached, nor does it sit in parallel with them. "Negotiation", laudable as it is, only coins the process by which the parties involved reach an agreement. "Mediation", also known as conciliation, refers to a system where a third party is involved in that process.[35] As much as a lot of expertise is needed, and the field has become increasingly sophisticated and specialized both according to the matter, and to the role played by the mediator/conciliator, the common ground remains the same: it is the parties' agreement (or the acknowledgement of the failure to reach such agreement by the mediator/conciliator) that puts an end to the process, and has the legal value of a contract, rather than an arbitral decision.

With that in mind, it is difficult not to draw a parallel with the dispute resolution mechanism envisaged in the OECD Model Convention, and followed by the US-Germany, US-Belgium or US-Canada Protocols. The so-called arbitration is contemplated not as an autonomous mechanism, but rather as an appendix to the MAP between competent tax authorities, to the extent that it is regulated in an additional paragraph to the provision on MAP, and for *issues* where such MAP fails to result in an agreement (under the OECD Model the authorities can still resolve the case by mutual agreement, and it will be the specific issue that will be resolved in arbitration).[36]

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also Announcement 2008-111 *Test of Procedures for Mediation and Arbitration for Offer in Compromise and Trust Fund Recovery Penalty Cases in Appeals*, Internal Revenue Bulletin: 2008-48, 1 Dec. 2008, available at http://www.irs.gov/Businesses/Arbitration-Procedures-for-Appeals.

34. *See*, for example, articles 4 and 7 of the 90/463/EEC Convention.

35. Andrew Tweddale & Keren Tweddale, *supra* n. 31, at 6-10; Julian Lew, Loukas Mistelis & Stefan Kröll, *supra* n. 26, at 13-15.

36. Paragraph 62 of the OECD Commentary to Article 25 (paragraph 5) states that:

> The arbitration process provided for by the paragraph is not an alternative or additional recourse: where the competent authorities have reached an agreement that does not leave any unresolved issues as regards the application of the Convention, there are no unresolved issues that can be brought to arbitration even if the person who made the mutual agreement request does not consider that the agreement reached by the competent authorities provides a correct solution to the case. The paragraph is, therefore, an extension of the mutual agreement procedure that serves to enhance the effectiveness of that procedure by ensuring that where the competent authorities cannot reach an agreement on one or more issues that prevent the resolution of a case, a resolution of the case will still be possible by submitting those issues to arbitration. Thus, under the paragraph, the resolution of the case continues to be reached through the mutual agreement procedure, whilst the resolution of a particu-

In addition to this, the emphasis on the parties' control before, during and after the "arbitral" proceedings[37] is such that it can suggest an "enhanced" conciliation as much as a "diminished" arbitration. Finally, the effect of the decision rendered by the arbitral board will be that of an agreement (as if under the MAP) between the two CAs.[38]

Since the previous discussion could be dismissed as a matter of semantics, it is worth returning for a second to the initial statement that "arbitration" may be in the eye of the beholder. This association of ideas is not as casual as it may seem. Being a predominantly practical (as opposed to academic) discipline, "arbitration" can evoke in many practitioners not so much abstract concepts as an aesthetic canon, as to how a type of proceedings tends to run, and what issues tend to arise. As with the US judge who was asked to define "pornography", an arbitral practitioner may shy away from defining "arbitration" but would be sure to recognize it when seeing it. The problem with this is that so far, "tax arbitration" is in an embryonic stage, with no well-documented international tax arbitration disputes. In the absence of a sample for him to examine, our arbitration practitioner cannot conclude whether international tax arbitration has confounded its critics, and revealed itself as the quick, flexible and no-nonsense practical mechanism that he identifies with arbitration, or rather, it has materialized as the clumsy and bogged-down procedure prone to the type of stalling and strategic behaviour that could be anticipated from provisions in tax treaties.

Again, these objections could be dismissed, not as a matter of semantics, but of snobbery. Surely, arbitration is not always that quick, flexible and practical, and even if it were, different degrees of speed and flexibility could be tolerated without stretching the definition too much. As such, "tax arbitration" could be regarded as a specific type of arbitration, with its own peculiarities, not unlike other varieties, such as investment arbitration or securities arbitration.

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lar issue which is preventing agreement in the case is handled through an arbitration process. This distinguishes the process established in paragraph 5 from other forms of commercial or government-private party arbitration where the jurisdiction of the arbitral panel extends to resolving the whole case.

See also Adolfo J. Martín Jiménez, *supra* n. 19, at 6.4.

37. *See* sections 7.3. and 7.4.

38. *See*, for example, US-Belgium Protocol No. 6, (k), US-Germany Protocol No. XVI, 22, (k), US-Canada Protocol, article 21, which introduces new article XXVI, paragraph 7(e); or US-France Protocol, article X, which introduces new article 26, paragraph 5(e).

The initial reluctance to accept a new field among the (already crowded) arbitration "club" always involves some snobbery, and also insecurity. For an arbitration practitioner who presents as a multi-faceted expert with all-encompassing knowledge, the inclusion of tax as a discipline suitable for arbitration is particularly forbidding; as a result of the peculiarity and complexity of the disputes, but also of the need to reflect on whether some procedural specificities are needed as well.

However, the reluctance is also a manifestation of legitimate concerns about the suitability of current mechanisms for tax dispute resolution to achieve the same "results" that arbitration has been providing for decades, and that have made it worthy of the special protection dispensed by the legal order, in the form of court assistance and enforcement by regular courts.[39]

This protection is based, as a matter of law, on the parties' agreement, entered by their own volition prior to the dispute but, as a matter of history, is legitimated by the arbitral tribunals' record to serve the interests of the parties which appointed it. In other words, protecting and supporting a system of justice that presents itself as an "alternative" to the justice dispensed by ordinary courts, is only sound if that system proves to be a better mechanism for those types of dispute and the parties involved in them.[40] "Better", of course, does not mean that the substance of the decision must leave all parties equally happy. It means that all parties have an equally "fair" chance to present their case, and that, after having given due consideration to all views, arbitrators can give closure to the problem in a way that is both quick and definitive, but also sufficiently flexible to adjust to the parties' interests. From that perspective, the answer to the question of whether "tax arbitration" is, or is not "arbitration" is not in itself important, but is important as a means of ascertaining whether the mechanisms for resolving tax

39. *See* the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards, or articles 5 and 6 of the UNCITRAL Model Law on International Commercial Arbitration (1985 with 2006 amendments).

40. The understanding of arbitration as a "service" to the parties involved in it, and the claim that the current state of arbitration law can only be understood from that "service" perspective are ideas that first entered the academic discourse in the 1960s by means of Ms Ruvelin Devichi. Today they are coined as the "autonomous" theory of arbitration, as an alternative to the classic debate between the "contractual" theory of arbitration, which bases arbitration's legal standing on the parties' consent and agreement; and the "jurisdictional" theory of arbitration, which argues that such standing is based on the consideration of arbitration as an "alternative" jurisdiction, but jurisdiction after all; and the synthesis of the two: the "mixed" or "hybrid" theories. *See* Julian Lew, Loukas Mistelis & Stephan Kröll, *supra* n. 26, at 79-82.

disputes serve the parties' interests, and grant them a level of effectiveness akin to those of "arbitral" mechanisms; one that justifies an equivalent legal protection to the "final", "binding" and "enforceable" solution.

The answer to the question is "no", or, at least, "not without qualifications", which shows that sometimes disputes about concepts go beyond mere linguistic purity. This can be seen in the fact that the attempts to create arbitral solutions for tax disputes vary in the way the mechanism is referred to in the norm itself. Some, like the EC Convention, refer to an "advisory commission".[41] Others, like the OECD Model Tax Convention, the UN Model Tax Convention or the US Convention, talk about "arbitration",[42] but the names of the bodies entrusted with making the decision, albeit varying between "arbitration board"[43] or "arbitral panel",[44] fall shy of "tribunals". This ambivalence goes far beyond semantics, and encapsulates very well states' and tax authorities' mixed feelings towards arbitration: they want its advantages (professionalism, full-dedication, flexibility or expediency) but none of the disadvantages (discretion by the tribunal, and loss of control on the parties' side).

The process set forth in tax treaties could evolve into a full-blown arbitral process, but it contains too many inadequacies and uncertainties to consider it tantamount to arbitration. In the following sections it will be shown that states and CAs have done a thorough job in clipping the system's wings, and undermining its potential for effectiveness and usefulness. The system, as such, can be praised as "consistent", albeit it is, alas, consistent in its mediocrity. And while that may work in the authorities' short-term interests, it is self-defeating in the long run, since it also leaves *the authorities'* (not just the taxpayers') issues unresolved, to say nothing of the fact that such a "hybrid" system creates problems of its own, to which conventional arbitration principles have no easy answer. To these we now turn.

41. Art. 7(1) EC Convention 90/463/EEC.
42. Art. 25(5) OECD Model Tax Convention; art. 25(5), para. 2 (alternative B) UN Model Tax Convention; US-Belgium Protocol, no. 6; US-Germany Protocol, XVI, 22; US-Canada Protocol, introducing new article XXVI(6); US-France Protocol, new article 25(5).
43. US-Belgium Protocol, no. 6, (b); US-Germany Protocol, XVI, 22, (b); US-Canada Protocol, introducing new article XXVI(6)(d).
44. OECD Model Tax Convention, Sample Agreement, nos. 12, 13(d), 15, commentary paragraphs 3, 9, 18, 30, 64, of which paragraph 64 is referenced under paragraph 18 of the commentary to the UN Convention; and the provisions of the Sample Model Agreement are referred to in the annex to the Commentary on Article 25; US-France Protocol, new article 25(5)(e).

7.3. Consent and jurisdiction

No matter the perspective one has on arbitration, the concept that consent provides the basis for arbitral jurisdiction is settled. This single-minded focus poses serious questions for tax arbitration, as to *who* has consented to have their disputes arbitrated, and *what* kind of disputes are encompassed by such consent. The answer to both questions determines, in turn, the jurisdiction *rationae personae* and *rationae materiae* of the arbitral tribunal in tax disputes. These issues will be examined under section 7.3.1., preceded by an inquiry into the configuration of competence to decide on the arbitrators' jurisdiction, which, worryingly – albeit unsurprisingly – presents (again) specialties in the tax context. Section 7.3.2. will be dedicated to the specific issue of "two-tier" proceedings, where arbitration is preceded by a period where one or both parties are expected to resort to a different mechanism to try and resolve the dispute. The visible (some would say oppressive) presence of the "previous" stage in tax disputes makes the subject worthy of separate attention.

7.3.1. Jurisdiction/Arbitrability

7.3.1.1. Jurisdiction *rationae personae*

Consent is the basis of arbitration. The commitment of free will to resolving all future disputes arising in a certain context by arbitration is what justifies the parties' waiver of their rights to access other fora. Yet, consent is a tricky issue in tax arbitration. First, there is the issue concerning the state, with its sovereign powers on taxation, and its sub-state tax authorities (*see* section 7.3.1.1.1.). Second, there is the investor or taxpayer, whose actual status as a party is a subject of controversy (*see* section 7.3.1.1.2.).

7.3.1.1.1. *The state and its authorities. Issues with sovereign immunity and sub-state entities*

When focusing on the state and its public authorities vis-à-vis arbitration proceedings, the first question we are confronted with is whether a public authority *can* actually be a party to such proceedings. The same issue could well be addressed under the heading on jurisdiction *rationae materiae*. If it is included here it is because the primary obstacle one has to deal with is the state's status as a party (and, more specifically, as a respondent) in judicial or arbitral proceedings.

The state's immunity of jurisdiction and execution has long been a matter of controversy, as to its sources and its limits. Until recently, there were still doubts as to whether it was an issue of comity, and thereby based on reciprocity, or else a matter of law. The ICJ has greatly contributed to the clarification of this and many other aspects, in its ruling *Germany v. Italy*,[45] where immunity was considered to be a matter of law,[46] and thereby not one of comity.

In so doing, the ICJ confirmed much of the conventional wisdom on sovereign immunity, including the "functional", rather than "absolute" approach to sovereign immunity,[47] and this permits the possibility of waiver by an act of consent by the state. Whether a sovereign state can be the subject of (arbitral) proceedings involving organs other than its own courts is a settled matter. The extent of such jurisdiction could, potentially, be a more controversial issue, but one that bears a more direct relationship with matters of jurisdiction *rationae materiae*.[48]

A second aspect of the "state" side of the dispute concerns the doubt as to *who* is really a party to the proceedings. In both the OECD and UN Model Tax Conventions, as well as in specific treaties, the MAP, to which arbitration is attached, takes place between *CAs* (i.e. tax administrations or agencies).[49] This would imply that, if arbitration ensues, the same authorities are parties to the proceedings.[50] This solution is far from satisfactory,

45. Jurisdictional Immunities of the State (*Germany v. Italy: Greece Intervening*), 3 Feb. 2012, General List 143.
46. Id., paragraphs 54 to 58 (specifically, customary law, in the case of both countries). Furthermore, the ICJ also clarified the uncomfortable relationship between sovereign immunity and human rights, by definitively holding that state courts cannot adjudicate on a dispute with another state, even in cases of gross violations of human rights since human rights law is a matter of substance, whereas sovereign immunity has an incidence on procedure. *See* id., paragraph 93.
47. The "functional" approach, i.e. that immunity (of jurisdiction, primarily) depends on the nature of the acts performed by a state. *See* Karl M. Meessen, *State Immunity in the Arbitral Process*, in Norbert Horn & Stefan Kröll (eds.), *Arbitrating Foreign Investment Disputes*, The Hague, Kluwer Law International, 2004, at 387, and references to the approach in Germany, the United Kingdom and the United States.
48. *See* section 7.3.1.2.
49. Article 25(5) OECD Model Tax Convention; art. 25(5) (alternative B) UN Model Tax Convention; US-Belgium Protocol, no. 6; US-Germany Protocol, XVI, 22; US-Canada Protocol, introducing new article XXVI(6); US-France Protocol, new article 25(5).
50. OECD Model Tax Convention Sample Agreement nos. 8, 9, 10, 12, 13(e), 14, 15, 16, 17; UN Model Tax Convention, commentary to article 25(5) (alternative B) paragraphs 12, 13, 14, 16 (to name some); US-Belgium Protocol, no. 6, para. 1; US-Germany Protocol, XVI, 22, para. 1; US-Canada Protocol, introducing new article XXVI(6), para. 1; US-France Protocol, new article 25(5), para. 1.

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