Gerrit Groen

Sovereignty and Tax Treaty Dispute Settlement

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Why this book?
States have been reluctant to accept arbitration as a complement to the mutual agreement procedure (MAP) to settle tax treaty disputes. They fear that arbitration will result in an undesirable loss of fiscal sovereignty. Whether such loss in fact occurs – and why this would be undesirable – has not been studied in much detail in international tax literature. This book fills this gap by providing in Part II an analysis of the actual loss of sovereignty suffered by the disputing states in the recently introduced MAP/arbitration procedures of the Multilateral Instrument (MLI) and the EU Dispute Resolution Directive (DRD) on the basis of the criteria of access, independence and enforceability. The outcome of this analysis is used to develop the view that these procedures do not strike the right balance between the affected taxpayer's right to have double taxation eliminated and a state's right to maintain a certain freedom to regulate in the general interest, including the possibility to mitigate the abuse of tax treaties.

Part IV of this book contains a proposal for a new mandatory MAP/arbitration procedure. The proposal takes into consideration the not always positive experience of states with the long-established practice of arbitration in international investment agreements to settle disputes between an investor and a host state as described in Part III of this book. The newly proposed mandatory MAP/arbitration procedure is based on the notion of "selective judicialization", which implies that cases which are sensitive from the perspective of democratic self-determination may be excluded from its scope. This notion, however, equally implies that cases that are validly made and fall within its scope must be resolved in a fair and transparent way that provides the affected taxpayer relief from double taxation. The proposal, in particular, focuses on the role of the affected taxpayer in the procedure, the required limitations in the material scope of the arbitration procedure and the required level of institutionalization and judicialization of the arbitration procedure in order to improve its effectiveness.

Title:	Sovereignty and Tax Treaty Dispute Settlement
Date of publication:	December 2024
ISBN:	978-90-8722-932-0 (print), 978-90-8722-934-4 (PDF), 978-90-8722-933-7 (e-pub)
Type of publication:	Book
Number of pages:	290
Terms:	Shipping fees apply. Shipping information is available on our website.
Price (print/online):	EUR 120 | USD 145 (VAT excl.)
Price (eBook: e-Pub or PDF):	EUR 96 | USD 116 (VAT excl.)

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Gerrit Groen

This book is based on the thesis submitted for
a doctoral degree at the University of Amsterdam

Volume 75
IBFD Doctoral Series

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ISBN 978-90-8722-932-0 (print)
ISBN 978-90-8722-933-7 (eBook, ePub); 978-90-8722-934-4 (eBook, PDF)
ISSN 1570-7164 (print); 2589-9619 (electronic)
NUR 826

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A Proposal for a Mandatory MAP/Arbitration Procedure

Abbreviations and Acronyms

ADRC	Alternative Dispute Resolution Commission
APA	Advance Pricing Agreement
ATP	Aggressive Tax Planning
BEAT	Base Erosion and Anti-Abuse Tax
BEPS	Base Erosion and Profit Shifting
BEPS IF	BEPS Inclusive Framework
BIT	Bilateral Investment Treaty
CETA	Comprehensive Economic and Trade Agreement
CoC	Code of Conduct
CRA	Canada Revenue Authorities
CTA	Covered Tax Agreements
CTPA	Center for Tax Policy and Administration
DRD	Dispute Resolution Directive
ECHR	European Convention on Human Rights
ECJ	European Court of Justice
ECOFIN	Economic and Financial Affairs Council
ECT	Energy Charter Treaty
ECtHR	European Court of Human Rights
EU	European Union
FET	Fair and Equitable Treatment
GAARs	General Anti-Avoidance Rules
GLoBE	Global Anti-Base Erosion
IBA	International Bar Association
ICCPR	International Covenant on Civil and Political Rights
ICJ	International Court of Justice
ICS	Investment Court System
ICSID	International Centre for Settlement of Investment Disputes
IF	Inclusive Framework
IFA	International Fiscal Association
IIA	International Investment Agreement
ISDS	Investor-State Dispute Settlement
IRS	Internal Revenue Service
JTPF	Joint Transfer Pricing Forum
MAP	Mutual Agreement Procedure
MEMAP	Manual on Effective Mutual Agreement Procedure
MIC	Multilateral Investment Court
MLI	Multilateral Instrument
MLC	Multilateral Convention
MNC	Multinational Corporation
NAFTA	North American Free Trade Agreement

NDTP	Non-Disputing Treaty Party
NGO	Non-Governmental Organization
OECD	Organization for Economic Cooperation and Development
OECD MC	OECD Model Convention
PCA	Permanent Court of Arbitration
PE	Permanent Establishment
PPT	Principal Purpose Test
SAARs	Specific Anti-Avoidance Rules
SMAA	Sample Mutual Agreement on Arbitration
SSDS	State-to-State Dispute Settlement
TCC	Tax Court of Canada
TCJA	Tax Cuts and Jobs Act
TFEU	Treaty on the Functioning of the European Union
TIP	Treaty with Investment Provision
TP	Transfer Pricing
TTIP	Transatlantic Trade and Investment Partnership Agreement
TPP	Trans-Pacific Partnership
UK	United Kingdom
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
US	United States
USMCA	United States Mexico Canada Agreement
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organization

Chapter 1

Introduction and Research Question

Tax treaties are designed to coordinate the tax systems of the contracting states involved to eliminate double taxation and prevent tax evasion and avoidance but are not always able to do so coherently and consistently. Tax treaties are often worded in general and abstract terms and do not always fit seamlessly in the domestic tax systems of the contracting states. The tax authorities may, therefore, unintentionally take opposing positions when they interpret or apply a tax treaty to a specific case, resulting in double taxation or double non- or low taxation. Furthermore, tax treaty provisions are sometimes wilfully ignored or overridden by the legislator or tax authorities to curb tax treaty abuse or for other domestic tax policy reasons.

Tax treaty disputes can be resolved before domestic courts but there is no guarantee that such domestic proceedings will produce consistent results in both contracting states. The only way a uniform interpretation and application of tax treaties can be achieved is through an international dispute settlement mechanism. The classic mechanism that most current tax treaties provide for is the Mutual Agreement Procedure (MAP). This procedure consists of negotiations between the competent authorities of both contracting states and resembles to a certain extent diplomatic protection as the affected taxpayer has no access to the dispute settlement procedure in his own right but needs to request the help of a competent authority to take up his case. The MAP is generally perceived as an ineffective procedure mainly because the competent authorities are under no obligation to take up an affected taxpayer's case or to reach an agreement. To improve the effectiveness of the procedure, the MAP has been supplemented by an arbitration procedure for those issues that remain unresolved in a MAP. The acceptance of the arbitration procedure over the past decades has been slow, but the recent adoption of part VI of the Multilateral Instrument (MLI) by several states and the adoption of the European Union (EU) Dispute Resolution Directive (DRD) suggests an increase in the receptiveness to arbitration by at least developed countries.[1]

1. Organization for Economic Cooperation and Development (OECD), *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, November 24, 2016, and Council Directive (EU) 2017/1852 of 10 October 2017 on Tax Dispute Resolution Mechanisms in the European Union, OJ L265/1. It should be noted that the DRD does not use the term "*arbitration*" to identify the second phase of the

The most identified issue with the arbitration of tax treaty disputes is the impact it may have on the sovereignty of the states involved.[2] Sovereignty in tax matters constitutes the ability of a state to tax persons, assets and activities that are subject to its personal or territorial sovereignty. Such ability is a critical attribute of a state's sovereignty as it allows a state to raise revenue, provide public goods and redistribute wealth amongst its citizens. It has even been argued that: "Taxation is so essential to sovereignty that autonomy in designing the tax system deserves greater protection than autonomy in other regulatory areas".[3]

An explicit loss of fiscal sovereignty is, therefore, hardly ever tolerated even within highly integrated unions of states such as the EU.

There is, however, considerable uncertainty as to the exact nature, scope and meaning of sovereignty as the: "concept of sovereignty varies dramatically depending on the subject under discussion".[4]

Because of the multifaceted nature of the concept, both supporters and opponents of arbitration of tax treaty disputes have been using different aspects of sovereignty to support their claims. Supporters of arbitration typically argue that because states have agreed to limit their sovereign rights to tax certain items of income or capital by entering into tax treaties, they should accept the consequence of committing themselves to resolve every dispute that arises from the interpretation or application of such treaties. These supporters present the adoption of arbitration in tax treaties as a natural implication of the principle of *pacta sunct servanda*. Patricia A. Brown, for example, argues that:

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dispute settlement procedure, but instead uses the term *"dispute resolution by the advisory commission"* and refers to the decision of the advisory commission as the "*opinion*". For ease of reference in this study the dispute settlement procedure in the DRD may, however, be referred to as the MAP/arbitration procedure.

2. See, for instance, William W. Park and David R. Tillinghast, *Income Tax Treaty Arbitration*, Sdu Fiscale & Financiele Uitgevers, 2004, p. 11; United Nations (UN) Committee of Experts on International Cooperation in Tax Matters, *Secretariat Paper on Alternative Dispute Resolution in Taxation*, Geneva, October 2015, p. 19; and Qiang Cai, *Behind Sovereignty: Concerns About International Tax Arbitration and How They May Be Addressed,* British Tax Review, No. 4, 2018, p. 442.

3. Allison Christians, *Sovereignty, Taxation and Social Contract*, Minnesota Journal of International Law, 245, 2009, p. 7.

4. Michael Ross Fowler and Julie Martie Bunck, *Law, Power, and the Sovereign State, the Evolution and Application of the Concept of Sovereignty,* University Park: The Pennsylvania State University Press, 1995, p. 6. See also: W. Michael Reisman, *Sovereignty and Human Rights in Contemporary International Law*, 84 American Journal of International Law, 1990, p. 866.

> A country that enters into any sort of binding international agreement does so as an exercise of its sovereignty. Once it does so, it has accepted the obligation to apply the provisions of the agreement in good faith.[5]

William Park and David Tillinghast in their International Fiscal Association (IFA)-sponsored study on tax treaty arbitration claim that:

> The concern to avoid tax-induced trade distortions is reflected in the very concept of an income tax treaty, which implies some renunciation of taxing competence by the country of source. The time has come for treaty partners to take the next step, and to recognize their common interest in establishing orderly and efficient mechanisms for settling controversies that inhibit cross-border flows of goods, services or capital. Taxation consistent with the letter and the spirit of the tax treaty will bring aggregate benefits to the economies of both sides of the treaty.[6]

Proponents of arbitration often present arbitration as a tool to improve taxpayer's rights. They may claim that tax treaties provide substantive rights to taxpayers and that for that reason taxpayers should also obtain the procedural rights to independently enforce such rights in an arbitration procedure. In her doctoral thesis on taxpayer participation in tax treaty dispute settlement, Katherine Perrou has argued that: "Taxpayers, however, derive rights directly from the double taxation conventions and where a substantive right exists there must be an effective procedural right that guarantees the enjoyment of the substantive right (ubi jus ibi remedium)".[7]

Proponents of arbitration may further argue that if states accept arbitration in international investment agreements (IIAs) and other areas of international economic law, it is difficult to see why they should not accept arbitration for tax treaty disputes, given the similarities between international tax law and international investment law.[8] Often, such commentators may point to investor-state dispute settlement mechanisms (ISDSs) in IIAs as a model of how arbitration under tax treaties could operate. In his general report on the impact of investment treaties on taxation, Pasquale Pistone argues that the absence in tax treaty arbitration of the right for taxpayers to initiate arbitration against the will of states and to participate in the dispute settlement procedure may raise "questions of the compatibility of such procedures with

5. Patricia A. Brown, *Enhancing the Mutual Agreement Procedure by Adopting Appropriate Arbitration Provisions*, in: Michael Lang, Jeffrey Owens (eds.), *International Arbitration in Tax Matters*, IBFD, 2015, p. 105. See also: Cai, *supra* n. 2, p. 442.
6. Park and Tillinghast, *supra* n. 2, p. 72.
7. Katherine Perrou, *Taxpayer Participation in Tax Treaty Dispute Resolution*, IBFD, 2014, p. 83.
8. Id., p. 106.

the principles of due process, particularly in cases in which the taxpayer is required to waive or suspend domestic remedies so that arbitration can take place". He continues by writing that:

> this is also the reason why we argue for achieving the effective protection of taxpayers' rights in cross-border disputes and believe that arbitration clauses under BITs are an important tool for improving the current conditions under which the rights of taxpayers are protected.[9]

States that are in favour of arbitration are typically very concerned about the potential loss of sovereignty and are for that reason less focused on the protection of the taxpayer in the procedure and use different arguments to support their position. They may downplay the importance of the loss of sovereignty in the arbitration procedure by arguing that through careful drafting of the procedure, the impact of such loss can be mitigated and/or eliminated. Douglas O'Donnell, a senior official from the United States (US) Internal Revenue Service (IRS) references so-called "last-best offer arbitration" as a solution to the problem.[10] In this type of arbitration, the arbitration panel must pick between the positions put forward by the two contracting states and cannot develop its own solution. Another illustration of such a sovereignty-preserving approach is the fact that in tax treaty arbitration states may ignore the arbitration decision if they succeed in removing the double taxation at the root of the dispute.

In a similar vein, state officials have argued that the inclusion of an arbitration provision acts as a strong incentive for the competent authorities to resolve the dispute in a MAP, and for this reason, the loss of sovereignty that may occur if the dispute is settled through arbitration by a third party will hardly ever become a reality.[11] As pointed out by Allison Christians under such line of reasoning:

> International tax arbitration is claimed by its designers to be a threat rather than a promise. Its intended role is as a stick to compel the competent authorities to come to an agreement reasonably and in a timely manner.[12]

9. Pasquale Pistone, *The Impact of Bilateral Investment Treaties on Taxation (General Report),* in: Michael Lang, Jeffrey Owens, et al. (eds.), *The Impact of Bilateral Investment Treaties on Taxation,* IBFD, 2017, p. 43.
10. As reported by Kristen Parillo, *Competent Authorities Debate Sovereignty Argument Against Arbitration*, Tax Notes International, December 15, 2014, p. 996. "Last-Best Offer Arbitration" is in literature also referred to as "baseball arbitration".
11. Arno Oudijn, Head of the Tax Treaty Division in the International Tax and Consumer Tax Directorate of the Dutch Finance Ministry, as quoted by: Parillo, *supra* n. 10.
12. Allison Christians, *How Nations Share*, Indiana Law Journal, Vol. 87, 2011, p. 36.

Arbitration is then something to be avoided at all costs by the competent authorities as it is being viewed as "an embarrassment, or punishment even, for authorities having failed to resolve their dispute through settlement, instead of a useful addition to the toolkit of resolution instruments".[13]

Opponents of arbitration can typically be found amongst developing states, non-governmental organizations (NGOs) and some academics. The Minister of State for Finance of India, who is one of the strongest opponents of arbitration in tax treaty disputes, has argued that:

> One of the major concerns from the point of view of developing countries is regarding the approach adopted for making dispute resolution mechanisms more effective which includes introduction (sic) of mandatory and binding arbitration in the Mutual Agreement Procedure of the Tax Treaties. This not only impinges on the sovereign rights of developing countries in taxation but will also limit the ability of the developing countries to apply their domestic laws for taxing non-residents and foreign companies.[14]

Opponents typically argue that arbitration impinges on the sovereign rights of states because it is perceived to favour large multinational corporations (MNCs) that operate globally and may have access to tax treaty arbitration as an alternative means of dispute settlement over smaller businesses that mainly or only operate in domestic markets and only have access to domestic dispute settlement procedures. Also, they argue that arbitration may disadvantage developing countries, as they may lack the capacity and resources to deal with the ever-changing international tax rules and complex arbitration proceedings in an efficient manner.[15] Opponents of arbitration may, furthermore, point to the fact that the arbitration procedure lacks democratic legitimacy and transparency resulting in a lack of confidence and trust in the system.[16] They also contend that the pool of potential arbitrators

13. Hans Mooij, *MAP Arbitration in Tax Treaty Disputes,* in: Pasquale Pistone and Jan J.P. de Goede (eds.), *Flexible Multi-Tier Dispute Resolution in International Tax Disputes*, IBFD, 2020, p. 263.
14. Statement by the Indian Minister of State for Finance, *Nirmala Sitharama*, G20 Summit, Cairns, September 2014, available at: https://pib.gov.in/newsite/PrintRelease.aspx?relid=109886.
15. Michael Lennard, *International Tax Arbitration and Developing Countries,* in: Michael Lang, Jeffrey Owens (eds.), *International Arbitration in Tax Matters*, IBFD, 2015, pp. 446-450.
16. UN Committee of Experts on International Cooperation in Tax Matters, *supra* n. 2, p. 23, Lennard, *supra* n. 15, pp. 454 – 456. See also: Natalia Quinones, *An Unfinished Patchwork: An Assessment of the Current International Tax Dispute Resolution System from a Developing Country Perspective,* World Tax Journal, Vol. 14, No. 4, 2022.

is not diverse enough and may not represent the points of view of developing countries.[17]

Most commentators only use the sovereignty argument in passing and focus on those aspects of the concept of sovereignty that support their position. The sovereignty arguments pro and contra arbitration are often made without discussing:

1. the concept of sovereignty at depth;
2. the question under which circumstances a loss of sovereignty in the context of the settlement of tax treaty disputes may be expected;
3. the question of whether a loss of sovereignty in fact occurs when applying the legal instruments that allow for tax treaty arbitration;
4. why such a loss would be (un)desirable; and
5. how the outcome of the analysis under (1.) to (4.) may impact the design of a proposal to improve the MAP/arbitration procedure.

In other areas of international tax law, there has been more in-depth academic research on the topic. There is a relatively large number of publications on how the concept of fiscal sovereignty shapes arguments over the merits of tax competition between states and the design of responses to it by states and international organizations such as the Organization for Economic Cooperation and Development (OECD).[18] More recently, in the context of the OECD/G20 Base Erosion and Profit Shifting (BEPS) project, the academic work has expanded to also include the eroding effects of tax avoidance and aggressive tax planning (ATP) on fiscal sovereignty and how states should respond to this.[19] This work has resulted in several

17. UN Committee of Experts on International Cooperation in Tax Matters, Report by the Subcommittee on Dispute Resolution, *Arbitration as an Additional Mechanism to improve the Mutual Agreement Procedure*, Sixth Session, Geneva, 18-22 October 2010, E/C.18/2010/CRP.2, pp. 8-11, Lennard, *supra* n. 15, pp. 451-453.

18. For instance, see Diana Ring, *What's at Stake in the Sovereignty Debate?; International Tax and the Nation-State,* Boston College Law School Legal Studies Research Paper No. 153, April 14, 2008, Allison Christians, *Sovereignty, Taxation and Social Contract*, University of Wisconsin Law School, Legal Studies Research Paper Series, Paper No. 1063, August 29, 2008, Diana Ring, *Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Cooperation*, Boston College Law School Legal Studies Research Paper Series No. 171, January 28, 2009; and Pieter Dietsch and Thomas Rixen, *Tax Competition and Global Background Justice,* Journal of Political Philosophy, Vol. 22, Issue 2, 2014, pp. 150-177.

19. For a study on the tax sovereignty implications of tax avoidance and ATP, see Diane Ring, *One Nation Among Many: Policy Implications of Cross-Border Tax Arbitrage*, Boston College Law Review 44, 2002, pp. 79-176. For recent studies of the implications of BEPS on tax sovereignty, see L. van Apeldoorn, *BEPS, tax sovereignty and global justice*, Critical Review of International Social and Political Philosophy, Vol. 21, Issue 4, 2017, pp. 478-499 and Sergio Andre Rochas and Allison Christians (eds.), *Tax Sovereignty*

observations and conclusions about the concept of fiscal sovereignty in general and how it can guide the discussion on these various topics, which will be discussed throughout this book as relevant.

This book aims to fill the gap as outlined above by researching:
to what extent a loss of sovereignty could be tolerated by states in a tax treaty dispute settlement procedure to provide the taxpayer an effective protection against double taxation while maintaining the required national space to regulate in tax matters.

To tackle the research question, the text is divided into four parts.

Part I lays the necessary groundwork to answer the research question and proposes three criteria that may be applied to assess the extent of the loss of sovereignty in tax treaty dispute settlements. Chapter 2 of Part I begins by providing an overview of the historical development of currently existing tax treaty dispute settlement procedures in the OECD Model Convention (MC), the EU Arbitration Convention and the recently adopted MLI and the DRD. This chapter focuses on the origination of tax treaty disputes and the elevation of those disputes from domestic disputes between the taxpayer and the tax authorities to international disputes between the competent authorities of the contracting states to the tax treaty. It then provides a brief historical overview of the development of dispute settlement procedures from the introduction of the specific case MAP in the 1960s, the efforts to improve the effectiveness of the MAP and the addition of arbitration as a supplement to the MAP in the EU Arbitration Convention, article 25(5) OECD MC and more recently part VI of the MLI and the DRD. It also briefly discusses the recent developments with respect to dispute settlement in the context of BEPS Pillars One and Two. In the final section, this chapter provides a description of the commonly shared characteristics of the MAP and arbitration procedures in each of the dispute settlement procedures. Chapter 3 discusses the concept of sovereignty and its development in the context of the expanding role of non-state actors in international law, the ongoing

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in the BEPS Era, Series on International Taxation, Wolters Kluwer Law International, 2017. There are also many studies available on the related topic of the role and legitimacy of the OECD and other international organizations in shaping international tax policy. See for instance: Diane Ring, *Who is Making International Tax Policy?: International Organizations as Power Players in a High Stakes World,* Fordham International Law Journal, Vol. 33, Issue 3, 2009, pp. 649-715; Thomas Rixen, *From Double Taxation to Tax Competition: Explaining the Institutional Trajectory of International Tax Governance,* Review of International Political Economy, 2010, pp. 1-31 and Andrew Morris and Lotta Moberg, *Cartelizing Taxes: Understanding the OECD's Campaign against Harmful Tax Competition,* Columbia Journal Of Tax Law, Vol.4, Issue 1, 2012, pp. 1-64.

globalization of the economy and the need for cooperation amongst states to further their domestic economic agenda. It then puts forward the criteria "access", "independence" and "enforceability" that will be used to assess to what extent a loss of sovereignty in the context of tax treaty dispute settlement has occurred. Such an assessment assumes that states may, in principle, delegate the power to resolve tax treaty disputes to a third-party arbitration panel that operates outside the democratic control of such states. However, as discussed in the last section of Chapter 3, certain constitutional objections may exist against such delegation of power in mostly Latin-American countries and the EU.

Part II aims to debunk the "loss-of-sovereignty myth" surrounding the arbitration procedures. It does so by analysing the MAP/arbitration procedures that have most recently been adopted in part VI of the MLI and the DRD based on the criteria of access, independence, and enforceability. Chapter 4 discusses in more detail the ability of the taxpayer to initiate the MAP/arbitration procedure, possibly against the will of the competent authorities. As the arbitration procedure in the MLI and the DRD is construed as an extension of the MAP, it first analyses the material scope of the procedure and the ability of the taxpayer to access the MAP under the OECD MC and the DRD. It then discusses the additional limitations in the material scope of the arbitration procedure and the taxpayer's procedural rights to initiate the arbitration procedure. Chapter 5 discusses the ability of the arbitration panel to decide a case independent from state interest. This chapter first focuses on the composition of the arbitration panel and the required qualifications, independence, and impartiality of the arbitrators. It then describes the scope of the mandate granted to the arbitration panel and its ability to arrive at an independent reasoned opinion. It does so in the context of the rise in popularity of "last-best offer" arbitration, which purportedly limits the loss of sovereignty because the arbitration board must choose between the positions put forward by the competent authorities. It then turns its attention to the ability provided to the competent authorities to deviate from the arbitration decision. The chapter concludes with some remarks about the affected taxpayer's position in the procedure and the publication and the precedential value of the arbitration decision. Chapter 6 discusses the implementation and enforcement of the arbitration decision within the domestic legal order and assesses the role the taxpayer and the domestic courts play in this process. It also discusses a domestic court's ability to annul an arbitration decision at the request of the disputing states or the taxpayer.

In an excursion to the field of international investment law, Part III of this book compares the outcome of the analysis in Part II with the loss of

sovereignty under ISDS in IIAs and the negative impact this has on the ability to regulate in sensitive regulatory areas such as national security, the environment and public health. Chapter 7 first provides a brief overview of ISDS in IIAs and analyses, based on the criteria of access, independence and enforceability, the extent of the loss of sovereignty under ISDS. It specifically focuses on the investor's role as a formal party to the international dispute, the perceived bias of the party-appointed arbitrators, and the enforceability of the arbitration award. It concludes with some comments on the reform of ISDS that is currently ongoing that may be relevant for dispute settlement in tax treaties.

Based on the analysis performed in Parts II and III, Part IV formulates answers to the research question by proposing a new mandatory MAP/arbitration procedure to settle bilateral tax treaty disputes which is designed to strike the correct balance between protecting the taxpayer's right not to be taxed twice (or more) on the same item of income or capital and the state's right to maintain a certain level of regulatory freedom in areas that are sensitive from the perspective of democratic self-determination. This research should be placed in the context of a broader discussion within the international tax community about the need to provide taxpayers with tax certainty, such as by preventing disputes from arising through the use of bilateral Advance Pricing Agreements (APAs), better and more precisely worded tax treaties and commentaries, the issuance of bi- or multilateral administrative guidance on tax treaties through interpretative or legislative MAP, the harmonization of domestic tax laws and the conduct of simultaneous or joint audits. A detailed discussion of these topics goes, however, beyond the scope of this book.

Chapter 8 lays the groundwork for this proposal by analysing three critical issues that inform the design of a mandatory MAP/arbitration procedure that will be discussed in more detail in Chapters 9 and 10. It first discusses the principle of "selective judicialization" which implies that certain types of disputes that are sensitive from the perspective of democratic self-determination may be excluded from mandatory MAP/arbitration. It then discusses the required level of protection of a taxpayer's rights in the procedure to ensure that the cases that fall within the scope of the mandatory MAP/arbitration procedure are conducted both fairly and effectively. Chapter 8 continues with a discussion of the level of institutionalization of the mandatory MAP/arbitration procedure that may be required to level the playing field between developed and developing states and to secure the efficient conduct of this procedure.

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In an excursion to the field of international investment law, Part III of this book compares the outcome of the analysis in Part II with the loss of

sovereignty under ISDS in IIAs and the negative impact this has on the ability to regulate in sensitive regulatory areas such as national security, the environment and public health. Chapter 7 first provides a brief overview of ISDS in IIAs and analyses, based on the criteria of access, independence and enforceability, the extent of the loss of sovereignty under ISDS. It specifically focuses on the investor's role as a formal party to the international dispute, the perceived bias of the party-appointed arbitrators, and the enforceability of the arbitration award. It concludes with some comments on the reform of ISDS that is currently ongoing that may be relevant for dispute settlement in tax treaties.

Based on the analysis performed in Parts II and III, Part IV formulates answers to the research question by proposing a new mandatory MAP/arbitration procedure to settle bilateral tax treaty disputes which is designed to strike the correct balance between protecting the taxpayer's right not to be taxed twice (or more) on the same item of income or capital and the state's right to maintain a certain level of regulatory freedom in areas that are sensitive from the perspective of democratic self-determination. This research should be placed in the context of a broader discussion within the international tax community about the need to provide taxpayers with tax certainty, such as by preventing disputes from arising through the use of bilateral Advance Pricing Agreements (APAs), better and more precisely worded tax treaties and commentaries, the issuance of bi- or multilateral administrative guidance on tax treaties through interpretative or legislative MAP, the harmonization of domestic tax laws and the conduct of simultaneous or joint audits. A detailed discussion of these topics goes, however, beyond the scope of this book.

Chapter 8 lays the groundwork for this proposal by analysing three critical issues that inform the design of a mandatory MAP/arbitration procedure that will be discussed in more detail in Chapters 9 and 10. It first discusses the principle of "selective judicialization" which implies that certain types of disputes that are sensitive from the perspective of democratic self-determination may be excluded from mandatory MAP/arbitration. It then discusses the required level of protection of a taxpayer's rights in the procedure to ensure that the cases that fall within the scope of the mandatory MAP/arbitration procedure are conducted both fairly and effectively. Chapter 8 continues with a discussion of the level of institutionalization of the mandatory MAP/arbitration procedure that may be required to level the playing field between developed and developing states and to secure the efficient conduct of this procedure.

Chapter 9 addresses the material scope of the proposed mandatory MAP/arbitration procedure. It first analyses the complicated relationship of tax treaties with domestic law and whether domestic courts should have a monopoly on the interpretation and application of domestic tax law provisions. It, furthermore, discusses cases where the outcome of a MAP/arbitration procedure may not be implemented in the legal order, such as cases of tax treaty override or cases where from a constitutional perspective a competent authority cannot deviate from a court decision. It then analyses to what extent cases that involve taxpayers who are involved in improper behaviour to reduce their tax liability should be excluded from mandatory MAP/arbitration. It addresses whether cases involving the application of anti-avoidance rules, cases in which an affected taxpayer has been penalized for tax evasion and cases not involving double taxation should be excluded from arbitration. Chapter 10 examines the level of judicialization of the mandatory MAP/arbitration procedure from the perspective of the three criteria (i.e. access, independence, and enforceability) that is required to ensure that cases that fall within its material scope will be resolved in a fair and effective manner.

Part V in Chapter 11 presents an overall assessment and concluding remarks. Chapter 12 includes a postscript that discusses a recent proposal introduced by the OECD secretariat designed to address bilateral tax treaty dispute settlement in the context of BEPS Pillar One.

Part I

Setting the Stage: Loss of Sovereignty and Tax Treaty Dispute Settlement

Chapter 2

History and Basic Structure of Existing Tax Treaty Dispute Settlement Mechanisms

2.1. Origination of tax treaty disputes and the mechanisms to resolve them

Tax treaties have a dual nature. They are international agreements entered into between states in which they oblige themselves to limit the exercise of their taxing jurisdiction. Tax treaties contain, however, self-executing provisions which become either directly, or via transposition, part of the domestic laws of each contracting state. They may, therefore, be applied and interpreted at the domestic level by a variety of stakeholders, including taxpayers, tax authorities and courts.

International tax treaty disputes most commonly originate from domestic disputes between a taxpayer and the tax authorities about the interpretation or application of a tax treaty. Such domestic disputes may arise when the tax authorities of one of the contracting states, as a result of a review of a tax return or a self-assessment, or in the context of a tax audit, deviate from the position taken by the taxpayer in his tax return or self-assessment and apply a "primary adjustment," which may result in double taxation of the same item of income or capital in both contracting states.

An affected taxpayer has various avenues available to deal with a domestic dispute on the interpretation or application of a tax treaty. A taxpayer may consider pursuing the matter through the domestic appeals process in the appropriate state. For example, if based on a primary adjustment, a non-resident taxpayer was assessed an amount of tax he considers not in accordance with the applicable tax treaty, he may appeal that assessment through the available appeals procedures in the source state. However, the affected taxpayer may also choose to seek a "corresponding adjustment" or a relief (exemption or credit) in his state of residence through the domestic appeals procedures available in that state.[20]

20. As an alternative to the domestic appeals procedure, a taxpayer may also turn to "self-help", by amending its position in a tax return in a state to reflect the primary adjustment by another state. If the tax authorities do not challenge the amended return, the taxpayer has successfully helped himself to a solution to double taxation. Certain states, including the US, prohibit the filing of amended returns in such cases. For instance, US

The pursuit of domestic remedies in one or both contracting states does not necessarily guarantee a consistent outcome. Since domestic appeals procedures involve a unilateral, uncoordinated application and/or interpretation of a tax treaty, the taxation in contravention of the treaty, potentially resulting in double taxation, may remain in place. Tax treaties, therefore, provide an international procedure to resolve tax treaty disputes between the contracting states, which is aimed at providing a coordinated and consistent solution. Tax treaties typically resolve disputes through the MAP which is sometimes (as in recent tax treaties) supplemented with an arbitration procedure. These mechanisms can be found in the MAP provisions of article 25(1) and (2) and the arbitration procedure of article 25(5) OECD MC, the MAP and arbitration procedure of chapters V and VI of the MLI and, within the European Union, the MAP and arbitration procedures of the EU Arbitration Convention and the DRD.[21] Article 25 of the UN Model Convention also contains a MAP and an (optional) arbitration procedure. The arbitration provision in article 25(5) (alternative B) of the UN Model Convention deviates, however, in some key respects from the arbitration procedure defined in the OECD MC.[22] The arbitration provision in the UN Model Convention is hardly ever adopted by developing states in their tax treaties and will, therefore, not be discussed separately, unless relevant to a particular issue.

2.2. Brief historical overview of the development of tax treaty dispute settlement mechanisms

The 1928 League of Nations Model included a MAP as well as an arbitration provision.[23] Article 13 of the League of Nations Model allowed the financial authorities of the contracting states to resolve difficulties, especially in situations that were not provided for by the Convention.

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transfer pricing regulations (1.482-1(a)(3)) state that "no untimely or amended returns will be permitted to decrease taxable income based on allocations or other adjustment with respect to controlled transactions".

21. EU Arbitration Convention: Convention 90/436/EEC of 23 July 1990 on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises, OJ L225/10, 20 August 1990.

22. The most notable deviation concerns the fact that only the competent authorities, and not the taxpayer, can initiate the arbitration procedure. See: Laura Turcan, *The UN Model Convention and its Relevance for the Global Tax Treaty Network,* IBFD, 2017, sec. 10.3.2 and Hugh J. Ault, *Tax Treaty Arbitration: A Reassessment*, in: George Kofler, Rutch Mason, Alexander Rust (eds.), *Thinker, Teacher, Traveler, Reimagining International tax, Essays in Honor of H. David Rosenbloom*, IBFD, 2021, pp. 27-28.

23. League of Nations, *Draft Convention for the Prevention of Double Taxation in the Special Matter of Direct Taxes,* October 1928, C.562.M.178.1928.II.

Furthermore, article 14 of the League of Nations Model allowed the contracting states to submit unresolved disputes regarding the interpretation or application of the Convention's provisions to arbitration but only if both parties agreed to initiate such procedure. The MAP, but not the arbitration provision, was subsequently included in the Mexico (1943) and the London (1946) Model Treaties.[24] It should be noted, however, that the MAP in these Model Conventions deviates considerably from the MAP that can currently be found in the OECD MC as it did not provide a mechanism for the taxpayer to initiate the procedure, but only permitted the financial authorities of the contracting states concerned to do so. These provisions will, therefore, not be discussed further.

A provision in which the affected taxpayer can initiate the MAP in a particular case was first introduced in article 25(1) and (2) of the 1963 OECD MC in which the mutual agreement procedure was entirely revisited and modernized. Since the introduction of the MAP provision in article 25 of the OECD MC (1963), the basic structure of the MAP has remained unchanged. The MAP in its current form consists of the specific case MAP in article 25(1) and (2) of OECD MC, which can be initiated by a taxpayer in cases in which the actions of one or both contracting states result, or will result, in taxation that is not in accordance with the tax treaty. Article 25(3) of the OECD MC also contains a MAP that can only be initiated by the competent authorities in case of difficulties or doubts in the interpretation of the tax treaty (i.e. interpretative MAP) and in cases of double taxation that have not been provided for in the treaty (i.e. legislative MAP). Most tax treaties that have been concluded since the introduction of the specific case MAP in the OECD MC include such a provision, but variations exist regarding certain aspects of the MAP, such as the time limits for the submission of a case, the material scope of the MAP and the implementation of the mutual agreement in the domestic legal order of both states.[25]

The specific case MAP has been heavily criticized as being too rooted in the antiquated notion of international law that regards the state as its only actor and views an individual as a mere object of the law. The main point

24. League of Nations, *Model Bilateral Convention for the Prevention of Double Taxation of Income, Mexico draft, C.88.M.88.1946.II.A,* League of Nations, *Model Bilateral Convention for the Prevention of Double Taxation if Income and Property, London draft, C.88.M.88.1946.II.A*. See also: H. M. Pit, *Onderling Overleg en Arbitrage onder Belastingverdragen*, Fed Fiscale Brochures, 2020, pp. 3-4.

25. See H. M. Pit, *Arbitration Under the OECD Model Convention: Follow-up under Double Tax Conventions: An Evaluation*, Intertax, Volume 42, No. 6/7, 2014, pp. 449 - 451. Some of the variations have been eliminated through the adoption of part V of the MLI, which contains a specific case MAP procedure.

of criticism is the fact that the competent authorities are under no obligation to resolve a dispute but should merely endeavour to do so.[26] A related point of criticism is that the MAP provides almost no procedural rights to the taxpayer guaranteeing that the procedure is initiated by the competent authorities in legitimate cases and, once initiated, is not unduly stalled or terminated.[27] The MAP has been compared to a black box because of its lack of transparency and guidance, thereby contributing to uncertainty and unpredictability with respect to the procedure itself as well as its outcome.[28] To support their arguments, commentators point to the fact that, over time, the number of pending MAP cases has increased substantially and that the average time it takes to resolve cases has become unreasonably long (if the cases get resolved at all).[29]

The OECD has recognized the shortcomings of the MAP but has consistently argued that the MAP is the best practice available and remains an efficient and flexible instrument for the elimination of tax treaty disputes.[30] Therefore, during the past decades, the OECD has mainly focused on improving the effectiveness of the procedure within the existing legal framework.[31] The OECD has also worked to increase the transparency of the procedure by publishing the Manual on Effective Mutual Agreement Procedure (MEMAP), which is intended as a guide to increase awareness of the MAP process and how it should function, working with tax administrations to publish country profiles on the functioning of the MAP and publishing statistics on the workings of the MAP.[32]

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26. M. Markham, *Seeking New Directions in Dispute Resolution Mechanisms: Do We Need a Revised Mutual Agreement Procedure?,* Bulletin for International Taxation, Vol. 70, No. 1/2, 2016; Brown, *supra* n. 5, p. 89.
27. Mario Zuger, *Arbitration under Tax Treaties, Improving Legal Protection in International Tax Law*, IBFD, 2001, pp. 11-16.
28. Brown, *supra* n. 5, p. 89. See also: John F. Avery Jones, *Arbitration and Publication of Decisions*, in: Michael Lang, Jeffrey Owens (eds.), *International Arbitration in Tax Matters*, IBFD, 2015, pp. 369-375.
29. Mooij, *supra* n. 13, p. 274.
30. See for instance the progress report by the OECD Committee on Fiscal Affairs on the work done on improving the resolution of cross-border tax disputes: OECD, *Improving the Process for Resolving International Tax Disputes*, Paris, July 24, 2004, p. 2.
31. See for instance the proposals for updates to the commentary to article 25 of the OECD MC in: OECD, *Proposals for Improving Mechanisms for the Resolution of Tax Treaty Disputes*, Public discussion draft, Paris, February 2006 and the updates to the commentary to article 25 of the OECD MC in: OECD, *Improving the Resolution of Tax Treaty Disputes*, Paris, February 2007, which were included in the 2008 update to the OECD MC.
32. The MEMAP is available at: https://www.oecd.org/tax/dispute/manualoneffectivemutualagreementproceduresmemap.htm; the MAP country profiles are available at:

In the context of action 14 of the OECD/G20 BEPS project, further work was done on improving the effectiveness of the MAP procedure. The final report on action 14 of the BEPS project (hereafter: BEPS action 14 report) recognizes that "Certain of the main obstacles to the resolution of treaty-related disputes through the mutual agreement procedure are issues regarding the extent of treaty obligations to provide MAP access".[33]

The BEPS action 14 report predicts that these issues may become more significant as a result of the work on BEPS, which introduces more stringent anti-abuse rules, such as the Principal Purpose Test (PPT), that will result in more controversy.[34] The BEPS action 14 report discusses several recommendations such as minimum standards and best practices to make the MAP more effective. These recommendations were designed to ensure that taxpayers who meet the formal requirements to gain access under paragraph 1 of article 25 of the OECD MC would have access to the MAP and that administrative processes are in place to promote the prevention or timely resolution of treaty-related disputes.[35] All jurisdictions that are part of the OECD/G20 BEPS Inclusive Framework (BEPS IF) have committed to a consistent implementation of the agreed minimum standards including a targeted monitoring of those standards through a peer review process.[36] Some of the minimum standards have been implemented through the MLI, which modifies certain provisions of designated tax treaties (i.e. covered tax agreements [CTAs]) between the signatories to the MLI.[37] Part V of the MLI (articles 16 and 17) implements the tax treaty-related BEPS action 14 minimum standards regarding access to MAP. Furthermore, the wording of

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https://www.oecd.org/tax/dispute/country-map-profiles.htm and the MAP statistics are available at: https://www.oecd.org/tax/dispute/mutual-agreement-procedure-statistics.htm (last visited Jan 22, 2022).

33. OECD, *Making Dispute Resolution Mechanisms More Effective, Action 14 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, 2015, p. 21.

34. Id., p. 21.

35. Id., p. 14.

36. The BEPS IF was established to ensure that interested countries and jurisdictions that are not members of the OECD or G20 can participate on an equal footing in the development of standards on BEPS related issues, while reviewing and monitoring the implementation of the OECD/G20 BEPS Project. It consists of 141 jurisdictions as of November, 2021 (see for a list of jurisdictions that are member of the BEPS IF: https://www.oecd.org/content/dam/oecd/en/topics/policy-issues/beps/inclusive-framework-on-beps-composition.pdf; and for a description of the peer review process and the peer review reports: https://www.oecd.org/tax/beps/beps-actions/action14/ (last visited May 22, 2022).

37. OECD, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting,* OECD, November 2016. The MLI was developed as a result of the outcome of the work on BEPS action 15 which was published in: OECD, *Developing A Multilateral Instrument to Modify Bilateral Tax Treaties – Action 15: 2015 Final Report,* OECD/G20 BEPS Project, OECD Publishing, October 2015.

the specific case MAP of article 25(1) and (2) of the OECD MC has been updated in the 2017 OECD MC and is almost identical to the wording of the specific case MAP of article 16 of the MLI. The OECD continues to work on improving the effectiveness of the MAP and as part of the 2020 evaluation of the peer review process invited stakeholders to provide input on several proposals that included additional elements aimed at strengthening the action 14 minimum standards regarding access to the MAP in eligible cases, prevention of disputes through advance pricing agreements (APAs) and an efficient functioning of the MAP.[38]

Arbitration, as a complementary mechanism to resolve tax treaty disputes, was seriously considered within the EU for the first time in the 1970s. In 1976, the EU Commission proposed a draft Directive that introduced arbitration as a complementary means to solve disputes between EU Member States arising over adjustments of profits between associated enterprises (i.e. transfer pricing [TP] disputes).[39] This Directive was never adopted, however, mainly because the Member States were concerned over the loss of sovereignty regarding the interpretation and application of the Directive to the European Court of Justice (ECJ) and the EU Commission. Instead, in 1990, the EU Member States agreed to a regular multilateral instrument (the EU Arbitration Convention) which was signed on July 23, 1990, by the then EU Member States and entered into force on January 1, 1995. The fact that the EU Arbitration Convention is governed by regular international public law rather than EU law means that the EU Commission and the ECJ have no competence with respect to the EU Arbitration Convention.[40] Furthermore, the EU Arbitration Convention, unlike an EU Directive, does not, in and of itself have priority over domestic law nor any direct effect. The constitutional laws of each of the contracting states instead determine the implementation of the EU Arbitration Convention into their domestic legal order. Finally, unlike its commitment to an EU instrument, once adopted, an EU Member State can unilaterally terminate its commitment to an international public law agreement such as the Arbitration Convention. Its commitment to an EU Directive can only be terminated by leaving the EU.

To tackle the practical problems posed by TP practices in the EU, including the functioning of the EU Arbitration Convention, the EU Council has

38. OECD, *BEPS Action 14: Making Dispute Resolution Mechanisms More Effective – 2020 Review, Public Consultation Document*, OECD/G20 BEPS Project, 2020.
39. For an extensive historical overview of the introduction of the EU Arbitration Convention and the DRD, see H. M. Pit, *Dispute Resolution in the EU*, IBFD, 2017, pp. 31-54.
40. Id., p. 118.

formed a Joint Transfer Pricing Forum (JTPF), which was, amongst others, tasked with the development of pragmatic solutions to the functioning of the EU Arbitration Convention.[41] Its members include representatives of the tax administrations of EU Member States and non-governmental experts from business and academics. Over the years, the JTPF has made numerous suggestions to improve the effectiveness of the EU Arbitration Convention, some of which have been included in a Code of Conduct (CoC). The CoC contains guidelines for the application of the EU Arbitration Convention and represents a political commitment by the EU Member States. It is not a legally enforceable instrument and therefore it does not represent EU secondary law.[42] Although a substantial number of cases have been submitted to MAPs under the EU Arbitration Convention, the arbitration procedure under the EU Arbitration Convention has not been widely used, which is attributed to the poor functioning of the dispute settlement procedure.[43]

In June 2015, the European Commission made the strengthening of the mechanisms for dispute resolution a key part of its Action Plan for a Fair and Efficient Corporate Tax System in order to more effectively eliminate causes of double taxation that the Commission considers contrary to the functioning of the internal market.[44] As part of this initiative, the EU Commission revitalized the idea of a Directive and on October 25, 2016, it published a proposal for a Directive for the Resolution of Disputes Resulting in Double Taxation.[45] The proposal provided for the settlement of disputes between EU Member States that resulted in double taxation through a MAP and, if the EU Member States involved failed to agree, through dispute resolution by

41. For an overview of the work of the JTPF, see: https://ec.europa.eu/taxation_customs/joint-transfer-pricing-forum_en (last visited Jan 23, 2022)

42. See: Pit, *supra* n. 39, pp. 205-212. The last revision of the CoC was published in 2015 by the JTPF in its *Final Report on Improving the Functioning of the Arbitration Convention*, JTPF/002/2015/EN, March 2015.

43. Based on statistics that are made available by the JTPF, it appears that many MAP cases that are eligible for arbitration under the EU Arbitration Convention are for a variety of reasons not moved to the arbitration phase. See: EU JTPF, *Overview of numbers submitted for Statistics on Pending Mutual Agreement Procedures (MAPs) under the Arbitration Convention (AC) at the end of 2019*, Brussel, March 2021, Taxud/D2.

44. Communication from the Commission to the European Parliament and the Council: *A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action*, COM (2015) 302 final, June 17, 2015.

45. European Commission, *Proposal for a Council Directive on Double Taxation Dispute Resolution Mechanisms in the European Union*, COM (2016) 686 final, October 25, 2016. The proposal includes an explanatory memorandum and is supported by an impact assessment, which has been published separately: European Commission, Commission Staff Working Document, *Impact Assessment Accompanying the document Proposal for a Council Directive on Double Taxation Dispute Resolution Mechanisms in the European Union*, SWD (2016) 343 final, October 25, 2016.

an advisory commission. It builds on and complements the EU Arbitration Convention by extending the scope beyond TP disputes to all cases of double taxation on business income by EU Member States and providing enforcement mechanisms to ensure that EU Member States cannot derail the dispute settlement procedure to the taxpayer's detriment. The proposal was criticized in literature mainly because it brought into its scope all cases of double taxation, including those that are not the result of a legal dispute over the interpretation or application of a tax treaty. The proposal, therefore, would have required an advisory commission to allocate taxing rights without any clear legal provision to be interpreted.[46] It was also criticized because it only applied to cases of double taxation of business income and left too many escapes for the EU Member States to avoid their treaty obligations.[47] On May 23, 2017, the Economic and Financial Affairs Council (ECOFIN) of the EU agreed on a revised Council Directive on Double Taxation Dispute Resolution Mechanisms in the European Union (hereafter referred to as Dispute Resolution Directive (DRD)). The DRD differs in many critical aspects from the proposal that was published in October of 2017.[48] The drafters of the DRD dealt with the criticism levelled at the proposal by limiting its material scope to disputes over the interpretation or application of tax treaties between EU Member States and by expanding the scope to all taxes covered by the tax treaty.

The dispute settlement procedure in the DRD serves as a more efficient and effective alternative to the dispute resolution mechanism to be found in tax treaties between EU Member States and the EU Arbitration Convention because, at critical junctures, it provides procedural rights to taxpayers who can then unlock the procedure if it is bogged down by the competent authorities. Article 1 of the DRD explicitly emphasizes that it also lays down the rights and obligations of the affected persons when such disputes arise. According to its preamble: "the DRD respects the fundamental rights and observes the principles recognized in particular by the Charter

46. Gerrit Groen, *The Scope of the Proposed Arbitration Directive,* Tax Notes International, May 3, 2017. See also: Filip Debelva and Joris Luts, *The European Commission's Proposal for Double Taxation Dispute Resolution: Turning the Tide?*, Bulletin for International Taxation, Vol. 71, No. 5, 2017.

47. Groen, *supra* n. 46.

48. For a discussion of the DRD that was adopted by the Council, see: Gerrit Groen, *Why the Revised EU Dispute Resolution Directive is a Big Step in the Right Direction*, Tax Notes International, July 31, 2017, Pit, *supra* n. 39, pp. 1149-1599 and Ronald Ismer and Sophia Piotrowski, in: Ekkehart Reimer and Alexander Rust (eds.), *Klaus Vogel on Double Taxation Conventions – Article 25: Mutual Agreement Procedure*, 5th ed., Kluwer Law International, 2021.

of Fundamental Rights of the European Union and seeks to ensure the full respect for the right to a fair trial and the freedom to conduct a business".

In the last decades of the 20th century, certain states also started to include arbitration provisions in their bilateral tax treaties; the US, the Netherlands, Germany and the United Kingdom (UK) made the inclusion of an arbitration clause part of their tax treaty policy.[49] As of the late 1990s, the OECD has also been working on an arbitration provision to be included in the OECD MC. Such a clause was included in the 2008 update in article 25(5) of the OECD MC. The annex to the commentary to article 25(5) of the OECD MC includes a sample mutual agreement on arbitration (SMAA) which the competent authorities may use to establish the mode of application of the arbitration procedure. The information included in a footnote to article 25(5) of the OECD MC made it clear that national law, policy or administrative considerations may not allow or justify this type of dispute resolution and that states should only include the provision in their bilateral tax treaties when they consider it appropriate to do so. Only a small number of tax treaties currently contain an arbitration provision to settle disputes as a final stage of the MAP and, as reported by Pit in 2014, less than half of these treaties provide for mandatory arbitration modelled after article 25(5) of the OECD MC.[50] The remainder of the tax treaties that include arbitration merely offer voluntary arbitration and require the special consent of the competent authorities to initiate the procedure.[51] The UN has also included a voluntary arbitration provision in its Model Convention in 2011, which in some key aspects deviates from the arbitration provision in the OECD MC.[52] As discussed in chapter 1, developing countries are generally opposed to arbitration and rarely adopt an arbitration provision in their tax treaties.[53]

As discussed earlier, the OECD/G20 BEPS project recognized that the effectiveness of the MAP needed to be improved. In this context, further

49. See Pit, *supra* n. 25, pp. 445-469. See for a discussion of the arbitration provisions in bilateral tax treaties as per 2002, Gerrit Groen, *Arbitration in Bilateral Tax Treaties*, Intertax, Vol. 30, No.1, 2002, pp. 3-27.
50. Pit, *supra* n. 25, p. 457.
51. For a discussion of the consent requirements for tax treaties that contained an arbitration provision in 2002, see Groen, *supra* n. 49.
52. For a discussion of the differences between the arbitration procedure in article 25(5) OECD MC and article 25(5) (alternative B) UN MC, see Laura Turcan, *The UN Model Convention and its Relevance for the Global Tax Treaty Network,* IBFD, 2017, par. 10.3.2, Hugh J. Ault, *Tax Treaty Arbitration: A Reassessment*, in: George Kofler, Rutch Mason, Alexander Rust (eds.), *Thinker, Teacher, Traveler, Reimagining International Tax, Essays in Honor of H. David Rosenbloom*, IBFD, 2021, pp. 27-28.
53. For an overview of the objections to arbitration by developing states, see Lennard, *supra* n. 15, pp. 446-459.

consideration has been given to the need to supplement the existing MAP provisions in tax treaties with an arbitration procedure. Somewhat unsurprisingly, the large and diverse group of states that are part of the BEPS IF failed to reach a consensus on the addition of an arbitration procedure to the MAP.[54] The BEPS action 14 public discussion draft cites familiar policy issues that contributed to the failure to reach an agreement: (i) loss of sovereignty; (ii) access and scope of the arbitration provision in article 25(5) of the OECD MC; and (iii) the coordination of the arbitration procedure with available domestic legal remedies.[55]

Several states that participated in the BEPS project that favoured arbitration committed themselves to implementing an arbitration clause in their tax treaties with one another. The BEPS action 14 report indicated that they would do so in the context of the development of the MLI under BEPS action 15. Within the ad hoc group that was responsible for drafting the MLI, a sub-group of 27 states worked on drafting an arbitration provision and a set of rules on how it might be applied. These rules are included in part VI of the MLI. These rules apply if both contracting states to a tax treaty have notified the MLI depositary that chapter VI applies to their tax treaties.[56] Unlike the other provisions of the MLI, part VI operates as a separate provision, which is not intended to modify related arbitration provisions in the CTA (if any) but instead applies in lieu of the tax treaty procedure. As of February 2022, 33 jurisdictions have indicated to the depository that they apply part VI of the MLI.[57] Furthermore, as part of the 2017 update to the

54. OECD, *Public Discussion Draft BEPS Action 14: Make Dispute Resolution Mechanisms More Effective*, 2014, p. 4.

55. Id., pp. 20-21.

56. See article 18 MLI: "A Party may choose to apply this Part with respect to its Covered Tax Agreements and shall notify the Depository accordingly. This Part shall apply in relation to two Contracting Jurisdictions with respect to a Covered Tax Agreement where both Contracting Jurisdictions have made such a notification". According to article 2(1)(a) MLI, a tax treaty qualifies as a CTA if each signatory party to the MLI has made a notification to the Depositary listing such tax treaty as being covered by the MLI.

57. These are: Andorra, Australia, Austria, Barbados, Belgium, Canada, Curacao, Denmark, Fiji, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Lesotho, Liechtenstein, Luxembourg, Malta, Mauritius, Namibia, Netherlands, New Zealand, Papua New Guinea, Portugal, Singapore, Slovenia, Spain, Sweden, Switzerland and the UK. See: www.oecd.org/tax/treaties/mli-database-matrix-options-and-reservations.htm (last visited: Feb 20, 2022). The US is an explicit supporter of tax treaty arbitration but is missing from the list because it did not sign the MLI. Some other countries, for example, Mexico and Chile, have occasionally included arbitration provision in their tax treaties but are also missing from the list. For a discussion of the various provisions of the MLI, including part VI (Arbitration), and its operation, see Pasquale Pistone and Nevia Cicin-Sain, *The Implementation and Lasting Effects of the Multilateral Instrument: General Report*, in: George Kofler, Michael Lang, Jeffrey Owens, Pasquale Pistone, Alexander Rust, Jozef Schuch, Karoline Spies and Claus Staringer (eds.), *The Implementation and*

OECD MC, the previously discussed footnote to article 25(5) of the OECD MC was removed in order to force states to make explicit reservations on the applicability of article 25(5) of the OECD MC. The SMAA was also revised substantially to align it to a large extent with the arbitration procedure included in part VI of the MLI.

2.3. Dispute resolution in the context of BEPS action 1 Pillar One and Pillar Two

Recognizing that the work on the BEPS project might not have delivered the desired results, the OECD continued its work in the context of BEPS action 1 (Tax Challenges Arising from Digitalization) and in 2020 issued two reports on Pillar One and Pillar Two.[58]

The proposal for Pillar One contains new nexus and profit allocation rules that establish taxing rights over a portion of the profits of large and highly profitable MNCs for market jurisdictions in which goods and services are supplied or consumers are located. According to the Pillar One report, these rules aim to ensure that, in an increasingly digital age, the allocation of taxing rights with respect to business profits is no longer exclusively constrained by reference to physical presence. The proposal contains a high-level outline of a new and innovative mandatory and binding multilateral dispute prevention and resolution mechanism that should provide in-scope MNCs with certainty over the application of the proposed Pillar One rules which, together with the substantive Pillar One rules, should be included in a new Multilateral Convention (MLC).[59]

Lasting Effects of the Multilateral Instrument, IBFD, 2021, pp. 3 – 85. This book also contains contributions from reporters from various jurisdictions on the implementation of the various provisions of the MLI in that jurisdiction, and the doctoral thesis of Nathalie Bravo, *A Multilateral Instrument for Updating the Tax Treaty Network*, IBFD, 2020.

58. OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, 2020, OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, 2020.

59. For a discussion of the proposals in the BluePrint, see Spyridon E. Malamis and Qiang Cai, *International Tax Dispute Resolution in Light of Pillar One: New Challenges and Opportunities,* Bulletin for International Taxation, Vol. 75, No. 2, 2021, Werner Hashlehner and Michael Kobetsky, *Arbitration after BEPS,* in: George Kofler, Rutch Mason, Alexander Rust (eds.), *Thinker, Teacher, Traveler, Reimagining International Tax, Essays in Honor of H. David Rosenbloom*, IBFD, 2021, pp. 228-233 and Howard Mann,

In May 2022, the OECD secretariat issued two consultation documents on dispute prevention and settlement in the context of Pillar One. The document "Pillar One – A Tax Certainty Framework for Amount A" contains detailed operative language regarding a multilateral prevention and dispute resolution mechanism for the purpose of obtaining input from stakeholders.[60] The document does not represent a consensus view of the BEPS IF members and the operational language itself highlights differing views of BEPS IF members on several critical issues. In October 2022, the OECD secretariat issued a "Progress Report on the Administration and Tax Certainty Aspects of Amount A of Pillar One".[61] The operative language in the progress report aligns fairly closely with the detailed operative language in the Tax Certainty Framework for Amount A Consultation Document issued in May 2022, with some notable differences. Given that the adoption of the Pillar One rules at the time of the writing of this text remains in limbo and the fact that operative language in these reports provides for *multilateral* prevention and settlement of disputes that are specific to the establishment of amount A, a detailed discussion of this language is beyond the scope of this book.[62]

The other consultation document on Pillar One published in May 2022 by the OECD secretariat deals with tax certainty regarding issues related to Amount A and contains an operative text for a bilateral mandatory and binding dispute settlement procedure for issues related to Amount A, i.e. TP and Permanent Establishment (PE) profit attribution cases, that are typically covered in bilateral tax treaties.[63] The "Progress Report on the Administration and Tax Certainty Aspects of Amount A of Pillar One" contains several updates in the operative text. The operative text is drafted in the form of provisions that may be included in the MLC and includes a commentary

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The Expanding Universe of International Tax Disputes: A Principled Analysis of the OECD International Tax Dispute Settlement Proposals, Asia Pacific Law Review, Vol. 23, No. 1, 2023, pp. 268-283.

60. OECD, *Public Consultation Document: Pillar One – Tax Certainty Framework for Amount A, 27 May – 10 June 22,* OECD, 2022. For an overview of the comments received on the consultation document see: https://www.oecd.org/tax/beps/public-comments-received-on-tax-certainty-aspects-under-amount-a-of-pillar-one.htm.

61. OECD, *Progress Report on the Administration and Tax Certainty Aspects of Amount A of Pillar One, Public Consultation 6 October – 11 November 2022*, OECD, 2022.

62. Regarding the status of the adoption of the Pillar One and Pillar Two rules, see Jefferson VanderWolk, *The OECD's Two-Pillar Tax Plan: It's Time To Face Reality,* Tax Notes International, March 23, 2023, p. 1207.

63. OECD*, Public Consultation Document: Pillar One – Tax certainty for issues related to Amount A, 27 May – 10 June 2022,* OECD, 2022. The comments on the public consultation report from interested are available at https://www.oecd.org/tax/beps/public-comments-received-on-tax-certainty-aspects-under-amount-a-of-pillar-one.htm.

Notes

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