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Policy statement

Arbitration in international tax matters

Commission on Taxation, 3 May 2000

French version

Introduction

In its 1999 programme for action, ICC reiterated its commitment to "encourage governments to accept compulsory arbitration in international tax conflicts." ICC has a long history of promoting arbitration as an appropriate and efficient means of resolving such taxation disputes, having issued a position paper on the subject in 1984. During the intervening 15 years, while there has been some progress in the international arena, the acceptance of proper arbitration provisions is still not widespread. In our view, the time is ripe to revisit the matter.

Based upon the broad experience of ICC in commercial arbitration, we believe that this form of dispute resolution is both attractive and effective. It presents significant advantages to businesses and governments. These include not only the cost-effective and equitable resolution of tax controversies, but also the enhancement of global economic growth and development through elimination of unintended instances of double taxation.

Therefore, we submit this position paper in order to encourage governments to adopt and promote the use of arbitration as a means of resolving international tax disputes. We recommend that compulsory and binding arbitration in international tax matters should be adopted in bilateral or multilateral tax conventions. We believe that the OECD is an appropriate forum in which to develop such instruments and we encourage all governments to negotiate bilateral or multilateral conventions for arbitration of tax controversies.

International tax dispute resolution

Most bilateral tax conventions provide for a mutual agreement procedure as a means of resolving disputes concerning the application of the convention to taxpayers. This procedure entails discussions between the competent authorities of the two signatory states.

The competent authority procedure has provided many benefits to international business and we believe it is the best method of resolving instances of double taxation. However, this process presents certain imperfections.

- Double taxation conventions generally encourage, but do not require, the competent authorities to eliminate double taxation. It is, therefore, possible that double taxation will remain after the mutual agreement procedure has been applied.
- The affected taxpayers are normally excluded from the competent authority deliberations or, in any event, have no official or guaranteed status in such deliberations.
- Double taxation conventions establish no procedural rules or time limits for competent authority proceedings, and specify no method for their implementation (although many conventions stipulate that competent authority agreements will be implemented notwithstanding national time limits).
- There are numerous procedural conflicts between competent authority and domestic examination and appeal rules.

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- Delays in reaching a conclusion of competent authority proceedings can be very long, and are of concern to businesses.
- Even if the competent authorities do eliminate double taxation, the taxpayer may not be neutral as to how this is achieved. The competent authority decision may not conform to national or treaty law, and may be influenced by extraneous factors such as other pending competent authority cases.

Binding and compulsory arbitration can eliminate or alleviate many of these concerns. Arbitration always reaches a conclusion, provides for impartial determinations with proper taxpayer participation, and applies law rather than expediency. While arbitration may also present delays, the process is orderly, predictable and transparent.

Current use of arbitration

As noted, there has been an important, albeit limited expansion in the use of arbitration in international taxation. We highlight three developments.

The EU Convention

In 1990, the states of the then European Community concluded a convention providing for the use of arbitration in certain international taxation disputes (the "EU Convention").⁽¹⁾ This Convention represents an important precedent which merits consideration in framing the appropriate terms for international arbitration provisions in general. The following characteristics of the EU Convention should be noted:

- It is a multilateral agreement.
- Arbitration is compulsory.
- The result of the arbitration is not technically binding, but the Convention does ensure that a binding result obtains. Following an arbitration decision, the competent authorities are provided an opportunity to achieve an alternative resolution, but it must be one which eliminates double taxation.
- The Convention applies to permanent establishments as well as companies.
- It applies to both juridical and economic double taxation. However, only those cases of double taxation arising from adjustments under Article 9 (Associated Enterprises) of the OECD Model Tax Convention on Income and Capital (the "OECD Model Convention") are covered.
- The taxpayer has the right to initiate arbitration ("right of initiative").
- The Convention establishes a timetable: the enterprise has 3 years to present the case to arbitration; the competent authorities have 2 years to resolve the matter under the mutual agreement procedure; if this does not occur, the competent authorities have 6 months to establish an "advisory commission," which commission has 6 months to decide the case.
- No rules of procedure are prescribed. These are to be determined by the competent authorities.
- No judicial review is permitted.
- Arbitration is not applicable in cases of "serious penalty."



Arbitration decisions must be implemented regardless of any domestic time limits. Such implementation may be by adjusting income or providing a tax credit.

Several aspects of the EU Convention could be adapted for use between various states in advancing the international arbitration of tax disputes. For example, the EU Convention demonstrates that a

multilateral convention is a realistic alternative to the adoption of arbitration clauses in bilateral conventions. The combination of arbitration and competent authority action in the EU Convention is interesting, and does ensure that double taxation is avoided, but not necessarily in accordance with legal principles or in a manner which is fair to the taxpayer. Other terms of the EU convention could be improved.

Transfer pricing issues are likely the primary focus of international arbitration. However, the limitation in the EU Convention to double taxation under Article 9 of the OECD Model Convention seems unduly restrictive, as other issues can and do arise.

The existence of effective arbitration procedures in tax matters is an incentive to governments to resolve cases of international double taxation through the mutual agreement procedure. Therefore, the lack of practical case experience under the EU Convention does not mean it has failed to serve its purpose. On the contrary, the absence of arbitration proceedings reflects the resolution of double taxation through mutual agreement, a result of significant advantage to both business and governments.

US Treaty Practice

For many years, the United States resisted including arbitration clauses in its double taxation conventions. More recently, a few such clauses have been accepted.⁽²⁾ Typically, they present the following noteworthy characteristics.

- Arbitration is not compulsory. It occurs only with the consent of both competent authorities and the taxpayer.
- The arbitration is binding on all parties (including the taxpayer).
- An exception is provided so that the competent authorities will not generally accede to arbitration concerning matters of tax policy or domestic law.
- Taxpayers are provided with the right to present their views.

This approach is rather more limited than the EU Convention. While we are encouraged that such a clause has been included in certain US conventions, the fact that arbitration is not compulsory is a major drawback. The exclusion for "tax policy or domestic law," while understandable in some respects, lacks the specificity appropriate to a provision requiring compulsory arbitration. As in the EU convention, there are no procedural rules and, in this case, no fixed delays.

OECD

The views of the Committee on Fiscal Affairs of the OECD regarding international tax arbitration have evolved. Arbitration is not expressly contemplated in the OECD Model Convention. In a 1984 report,⁽³⁾ it was concluded that "for the time being" it was not appropriate to recommend an arbitration procedure.

However, the Commentary to the OECD Model Convention does currently state that arbitration is a solution to the potential problem of failure of the competent authorities to eliminate double taxation.⁽⁴⁾ The 1995 transfer pricing guidelines note that developments since 1984 warrant reopening the

question and that the Committee on Fiscal Affairs has agreed to undertake a study of the topic and to supplement those guidelines, with the conclusions of the study when it is completed.

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We support such work and encourage the CFA to develop a provision to be added to the Model Convention providing for compulsory arbitration, along the lines of our recommendation below. We also urge the CFA to consider the appropriateness of arbitration outside the confines of transfer pricing. In addition, we believe that the CFA should undertake an examination of the feasibility of a multilateral arbitration convention among the member states which would also be open for accession, in appropriate circumstances, by non-member states, perhaps on the basis that arbitration would be available only where the states in question had entered into general conventions for the avoidance of double taxation with most other signatories.

Recommendation

We believe that states should adopt a system of compulsory and binding arbitration. Such provisions could be adopted as part of existing or future bilateral double taxation conventions, included in regional conventions dealing with taxation matters, or agreed upon as a free-standing international agreement.

The essential characteristics of such an arbitration clause should, we suggest, include the following:

- **Initiation.** The mutual agreement procedure, which has provided important benefits to taxpayers and tax administrations alike, should be followed in the first instance. Absent agreement between the competent authorities, either state may initiate arbitration. In addition, the affected taxpayers should have the right of initiative in all cases, whether or not the competent authorities have agreed to eliminate double taxation.
- **Compulsory.** Arbitration should be compulsory, whether initiated at the instance of a contracting state or a taxpayer.
- **Binding.** Arbitration should be binding. The affected states as well as the affected taxpayers should be bound by the arbitration decision.
- **Scope and basis.** The basic requirement to demand arbitration should be a prima facie case of double taxation, either juridical or economic. All forms of double taxation should be included, not merely cases arising under Article 9 (Associated Enterprises) of the OECD Model Convention. The arbitration decision should be based on law, including the domestic laws of the states parties to the arbitration, treaties and international law.
- **Procedure.** The clause should set out basic control mechanisms to ensure procedural fairness. In addition, it should establish a general procedural framework. One approach might be a choice of fora. A timetable should be clearly set out. Protection for confidentiality must be included which reflects, at a minimum, the protections offered under the domestic laws of the states involved; in effect, the highest applicable standard should apply.
- **Taxpayer participation.** "Affected taxpayers" should be defined to include all taxpayers whose taxation is affected in a manner which, taking the taxpayers as a whole, entails economic or juridical double taxation. Such affected taxpayers should have the right of initiative and also the right to discontinue where the arbitration was begun at their behest. They should be provided an opportunity to present their views, including the right to submit all relevant information and documentation, to present oral and written arguments in accordance with the procedural rules applicable, and to respond to arguments or evidence submitted by the states involved. The mandatory production of evidence should be subject to the limitations on production available under the governing domestic law.



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Result. The arbitration should in every case provide for the definite elimination of double taxation. The contracting states should undertake to implement the decision regardless of any other provision of domestic law, including otherwise applicable time limits. Implementation provisions should include reference to interest, correlative adjustments and similar matters which may be determined by the arbitrators.

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FOOTNOTES

(1) EC Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises, 90/436/EEC.

(2) In particular, the US-Germany Convention. Other conventions, including those with Canada, the Netherlands, France, Kazakhstan, Switzerland and Mexico also contemplate arbitration, but not immediately. No arbitration clause is included in the US Model Convention.

(3) Transfer Pricing and Multinational Enterprises -- Three Taxation Issues

(4) Paragraph 48 of the Commentary to Article 25 of the OECD Model Convention.

(5) OECD Report Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, para. 4.167-4.171.