



**International Chamber of Commerce**

*The world business organization*

## **Policy statement**

### **Arbitration in International Tax Matters**

#### **Bilateral Convention Article**

#### **Commission on Taxation**

The Commission on Taxation of the ICC prepared a Policy Statement concerning Arbitration in Tax Matters dated 3 May 2000 (the "ICC Policy Statement"). In order to assist in the implementation of arbitration in tax matters in conformity with the guidelines established in the ICC Policy Statement, the Commission has prepared a model article, which could be adopted in bilateral taxation conventions.

This draft Article is designed having regard to the OECD Model Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital (the "OECD Model"). It could, with appropriate modifications, be adopted in bilateral tax conventions based on other models.

Some bilateral conventions contain very brief arbitration provisions that do not reflect many of the guidelines referred to in the ICC Policy Statement. This draft proposes a somewhat more expansive article to accommodate those guidelines.

Following the draft Article is a commentary that raises a number of issues for further consideration, including matters not fully resolved in the draft, and notes some possible variations or alternatives to the provisions in the draft Article. The commentary also briefly notes the relationship between the draft and provisions found in certain agreements, including in particular the EC Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises (the "EC Convention") and some United States bilateral tax conventions.

#### **Article 25A - Arbitration**

1) If a case has been presented to either competent authority under paragraph 1 of Article 25, the case shall be submitted to an arbitration board according to the provisions of this Article at the request of the person who presented the case (in this Article referred to as the "taxpayer") if the competent authority to which the case was presented has not either itself or by mutual agreement with the competent authority of the other Contracting State arrived at a solution within two years of the date on which the case was so presented or if the taxpayer considers that the solution which has been arrived at is not in accordance with the Convention.

2) A request for arbitration must be made by the taxpayer in writing within one year after the two year time limit referred to in paragraph 1 to the competent authority to which the case was presented and the request must include the taxpayer's agreement to be bound by the decision of the arbitration board.

3) The two-year time limit referred to in paragraph 1 shall be extended in the following circumstances:

- a) The two-year limit may be waived by mutual agreement among the competent authorities, the taxpayer and any associated enterprises the profits of which are relevant in determining that double taxation may have resulted (the taxpayer and such other enterprises being referred to in this Article as the "affected taxpayers").
- b) If the case has also been submitted to a competent court or tribunal in either Contracting State, the two-year time limit shall be computed from the date on which a final judgment has been rendered and all delays for appeal therefrom have expired, or the date upon which the parties to such proceeding have definitively abandoned it.

#### **International Chamber of Commerce**

38 Cours Albert 1er, 75008 Paris, France

Tel +33 (0)1 49 53 28 28 Fax +33 (0)1 49 53 29 42

E-mail [icc@iccwbo.org](mailto:icc@iccwbo.org) Website [www.iccwbo.org](http://www.iccwbo.org)

4) The competent authorities shall establish an arbitration board for each specific case in the following manner:

a) An arbitration board shall consist of not less than three members. Each competent authority shall appoint the same number of members and these members shall agree on the appointment of the final member.

b) All the members of the arbitration board must be appointed within three months from the date on which the request for arbitration was made.

5) The competent authorities may agree on and instruct the arbitration board regarding specific rules of procedure not inconsistent with this Article. Otherwise, the arbitration board shall establish its own rules of procedure consistent with generally accepted principles of international arbitration.

6) The arbitration board shall be provided with information as follows:

a) Notwithstanding Article 26 (Exchange of Information), the competent authorities shall release to the arbitration board such information as is necessary for carrying out the arbitration procedure.

b) The arbitration board may require the affected taxpayers to produce information but subject to the limitations on production applicable under the domestic law applicable to them.

c) Arbitration board members (and their staffs) upon their appointment must agree in writing to abide by and be subject to the most restrictive confidentiality and disclosure provisions of both Contracting States and the Convention.

7) The affected taxpayers and their representatives shall be afforded the opportunity to submit relevant information, to present their oral or written arguments to the arbitration board and to respond to arguments or evidence submitted by the Contracting States, in accordance with the applicable procedural rules.

8) The taxpayer may, at any time, conclusively terminate the arbitration by notice to the arbitration board.

9) The arbitration board shall decide each specific case as follows:

a) The decision shall be made on the basis of the Convention, having regard to the domestic laws of the Contracting States and the principles of international law, with a view to eliminating double taxation.

b) The arbitration board shall adopt its opinion by simple majority.

c) The arbitration board shall deliver its opinion not more than one year from the date on which the matter was referred to it.

d) The arbitration board will provide to the competent authorities and to the affected taxpayers an explanation of its decision.

10) The decision of the arbitration board in a particular case shall be binding on both Contracting States and the taxpayer who presented the case to the competent authority, solely with respect to that case.

11) Costs for the arbitration proceedings will be borne in the following manner:

a) Each Contracting State shall bear the cost of remuneration for the member(s) appointed by it, as well as for its representation in the proceedings.

b) The affected taxpayers shall bear the cost of their representation in the proceedings.

c) All other costs of the arbitration board shall be shared equally between the Contracting States.

d) The arbitration board may decide on a different allocation of costs.

12) The competent authorities may agree to modify or supplement the procedures governing the arbitration board as set out in this Article; however, they shall continue to be bound by the general principles established herein.

13) Each Contracting State shall implement the conclusions of the arbitration board notwithstanding any other provision of domestic law, including otherwise applicable time limits.

#### Commentary to Draft Article 25.1

##### Paragraph 1

This paragraph defines the nature of cases which may give rise to arbitration, prescribes the delay allowed to the competent authorities before arbitration may be requested, establishes that arbitration is compulsory and sets out the taxpayer's right of initiative.

##### · Trigger event

Paragraph 1 is framed to complement the mutual agreement provision set forth in Article 25 of the OECD Model. The event which gives rise to a potential submission to arbitration is that the competent authority has not either itself or by mutual agreement with the other competent authority arrived at an appropriate solution to a matter presented under Article 25. The EU Convention speaks only of failure to reach an agreement but this paragraph follows the language of Article 25(2) of the OECD Model, which contemplates both unilateral and bilateral relief.

Arbitration may be invoked if the competent authorities fail to agree or, if they do agree, the taxpayer considers that the agreement is not in accordance with the convention. This is broader than the EU Convention, which mandates arbitration only where the competent authorities fail to reach an agreement that eliminates double taxation with respect to Article 9 issues.

##### · Time delay

The ICC Policy Statement emphasizes the importance of establishing a strict timetable. Generally, the possibility of arbitration should exist where the mutual agreement procedure has not yielded an appropriate solution within a prescribed period. A two-year limitation has been suggested in paragraph 1, the same as is adopted in the EU Convention and a number of bilateral conventions (e.g., France-Germany). A three-year period was adopted in the recent Germany-Austria convention. Other aspects of the timetable for arbitration are addressed in paragraphs 2, 4(c) and 9(c).

##### · Compulsory arbitration

One of the fundamental guidelines established in the ICC Policy Statement is that arbitration should be compulsory. This is reflected by the mandatory language of paragraph 1.

##### · Right of initiative

Paragraph 1 provides that arbitration may be required where the taxpayer considers that an appropriate solution has not been reached. It was suggested in the ICC Policy Statement that other affected taxpayers (such as the associated person in the case of an Article 9 adjustment) should be permitted to request arbitration. This suggestion has not been retained in the draft Article. It would entail a number of complex procedural provisions. Furthermore, it is not obvious that a taxpayer who did not institute competent authority consideration under Article 25 should be afforded the right of initiative. The matter requires, however, further consideration.

##### · Exclusion for domestic law

Some conventions, notably a number of U.S. conventions, include a provision that excludes arbitration if the matter concerns the tax policy or domestic tax law of either Contracting State. This exclusion is not found in the EU Convention and has not been adopted.

It should be clear that the arbitration board interprets and applies the convention and does not make decisions regarding domestic law or tax policy as such. However, such domestic law or tax policy might well be taken into account in construing or applying the convention. There is, therefore, concern that the exclusion could create confusion or uncertainty as to the scope and jurisdiction of the arbitration board.

If such an exclusion is included in the article, it should be limited to cases that concern exclusively the tax policy or domestic law of a Contracting State and supplemented by a provision in paragraph 8 that would prohibit the arbitration board from making a decision on such tax policy or domestic law. In this way, a case would not be excluded from arbitration merely because it might be considered to include an element of domestic law, but the arbitration board would not have the power to decide the specific issue of domestic law.

#### Paragraph 2

Where the conditions of paragraph 1 are met, the taxpayer may request arbitration. Paragraph 2 establishes that such a request must be made within one year following the expiry of the two-year period allowed to the competent authorities for arriving at a solution. In addition, the taxpayer's right to initiate arbitration is conditioned on a written agreement to be bound by the results of the arbitration. This requirement is found in most bilateral conventions. See also paragraph 10, which confirms that the arbitration decision is binding on the taxpayer.

#### Paragraph 3

This paragraph contemplates two circumstances in which the two-year time limit stipulated in paragraph 1 shall be extended.

##### · Mutual agreement

Subparagraph (a) is similar to Article 7(4) of the EU Convention, requiring the agreement of both competent authorities and the affected taxpayers.

Affected taxpayers are the taxpayer who presented the case and any associated enterprises the profits of which are relevant in determining that there may have been double taxation. However, since the scope of arbitration is broader in this draft Article than in the EU Convention, further consideration is required as to whether the agreement of such an associated enterprise should, indeed, be required.

##### · Collateral proceedings

Extension is also provided (subparagraph (b)) in the event that collateral judicial or administrative proceedings have been commenced. This rule is based on Article 7(1), paragraph 2 of the EU Convention. Such collateral proceedings are not generally referred to in bilateral conventions, or in Article 25 of the OECD Model. Article 7(3) of the EU Convention provides additional rules relating to such proceedings.

Article 8 of the EU Convention provides for an exception from arbitration where judicial or administrative proceedings have resulted in a final ruling that by reason of actions which have given rise to the circumstances of the case any of the enterprises concerned is liable to a serious penalty. If such a ruling is being sought, the competent authorities are permitted to stay the arbitration proceedings. This provision has not been included in the draft.

The matter of collateral proceedings in general requires further consideration.

#### Paragraph 4

The next several paragraphs deal with the establishment of the arbitration board and its procedure. The EU Convention and bilateral conventions provide different rules, and different levels of detail, regarding the mechanics of arbitration.

With respect to the establishment of the arbitration board, the EU Convention and some bilateral conventions (e.g., the Germany-United States Convention) provide for an arbitration board of at least three members while other conventions fix the number of arbitrators at three- (e.g., France-Germany). This draft Article opts for the flexibility of the "at least three" solution. The draft does not reproduce the rather more detailed procedural provisions found in the EU Convention concerning other aspects of the establishment of the arbitration board, such as the identity of arbitrators and the choice of the chairman.

The drafting of subparagraphs (a) and (b) of paragraph 4 is based on the Germany-United States convention. However, that convention also includes a final sentence that has not been retained: "The competent authorities may issue further instructions regarding the criteria for selecting the other member(s) of the arbitration board." This sentence was not considered necessary given the other provisions of the draft Article, in particular paragraphs 5 and 12.

Subparagraph (c) is based on the France-Germany convention and reflects the guideline expressed in the ICC Policy Statement that a timetable for the arbitration should be prescribed. The specific choice of a three month delay requires further consideration. As well, the precise mechanism of choosing arbitrators if they are not named within this delay remains to be determined. The France-Germany convention contains a reference to the Permanent Arbitration Court, which may not be appropriate in the case of the draft Article.

#### Paragraph 5

This paragraph provides in general terms for a method whereby the rules of procedure for the arbitration may be set, looking first to the competent authorities and, absent direction from them, to the board itself. While it is based on the Germany-United States and Mexico-United States conventions, those conventions also specify that the competent authorities may stipulate certain specific matters that are expressly prescribed in this draft, such as time limits. Therefore, this paragraph 5 includes language clarifying the precedence of procedural rules provided in other paragraphs of the draft Article over any competent authority agreement regarding procedure.

#### Paragraph 6

The arbitration board must obtain information in order to carry out the arbitration. The ICC Policy Statement underscores the importance of preserving the confidentiality of taxpayer information, reflected in this paragraph 6.

Subparagraph (a) provides for the obtaining of information from the competent authorities. It is derived from a provision common in the arbitration provisions of bilateral conventions. However, those other provisions are normally facultative while subparagraph (a) of the draft is mandatory. This seems appropriate since participation in the arbitration by the Contracting States is also mandatory.

Subparagraph (b) provides for the obtaining of information from taxpayers. It protects them against production beyond the national requirements otherwise applicable.

Subparagraph (c) is based on the Germany-United States and Mexico-United States conventions. It underscores the importance of preserving confidentiality throughout the arbitration procedure. The standard of confidentiality to be applied is the highest of the three potentially applicable rules: those imposed by each of the two domestic legal systems and by the Convention itself.

#### Paragraph 7

The ICC Policy Statement underscores the importance of taxpayers' rights of representation before an arbitration board. Bilateral conventions, such as the Germany-United States convention, as well as the EU Convention (Article 10), provide somewhat more limited rights of representation than those set forth in paragraph 7.

While subparagraph 6(b) provides that affected taxpayers may be required to produce information, paragraph 7 provides them with a positive right to provide such information as they deem appropriate, even if not requested by the arbitration board or the competent authorities. In addition, affected taxpayers (defined in subparagraph 3(a)) are afforded a positive right to present oral and written arguments, and to respond to arguments or evidence submitted by the Contracting States.

#### Paragraph 8

Paragraph 1 provides taxpayers with a right of initiative. Paragraph 8 provides a right of termination of

the arbitration by the initiating taxpayer, as suggested in the ICC Policy Statement. No such provision appears in bilateral conventions or the EU Convention.

#### Paragraph 9

This paragraph contains certain rules relating to the decisions of the arbitration board.

Subparagraph (a) confirms, in accordance with the ICC Policy Statement, that decisions should be based on law. The arbitration board should decide the case of double taxation presented with respect to the particular taxpayers, and not reflect "horse-trading" between Contracting States or other extraneous considerations. No such provision appears in bilateral conventions or the EU Convention. Subparagraph (b) provides for decisions by simple majority, as in Article 11(2) of the EU Convention. No such rule is found in US and some other bilateral conventions. It could be considered unnecessary, a matter left to the general procedural rule in paragraph 5.

Subparagraph (c) sets a time limit on the arbitration, reflecting the concern expressed in the ICC Policy Statement that the process should proceed in a timely manner. This subparagraph is based on Article 11 of the EU Convention. The draft Article suggests a limit of one year. While this could be considered short in complex fiscal arbitrations, it was considered appropriate having regard to the fact-finding process which will have already occurred in the mutual agreement procedure. It is intended that the one-year period begin to run once the members of the arbitration board have been chosen.

Subparagraph (d) provides for a reasoned arbitration decision. The bilateral conventions that contain such a requirement refer to the explanation being provided to the competent authorities only. Given the taxpayer's right of initiation and the enhanced participation of affected taxpayers (as defined in subparagraph 3(a)) in the arbitration, it is appropriate in this draft Article that the reasons be provided to the affected taxpayers as well as to the competent authorities.

#### Paragraph 10

A fundamental recommendation in the ICC Policy Statement is that arbitration decisions should be binding on the Contracting States. This is reflected in paragraph 10. However, the draft Article has not retained the suggestion that the decision be binding on affected taxpayers other than the taxpayer initiating the arbitration. This matter requires further consideration, but it does not seem appropriate for other taxpayers to be bound.

The draft Article states that the decision is binding "solely" with respect to the particular case. Some conventions (such as the Germany-United States convention) contain an additional sentence regarding the weight to be given arbitration decisions in other cases, to the following effect:

While the decision of the arbitration board shall not have precedential effect, it is expected that such decisions ordinarily will be taken into account in subsequent competent authority cases involving the same taxpayer, affected taxpayers, the same issue(s), and substantially similar facts, and may also be taken into account in other cases where appropriate.

Such a sentence may be added where countries consider it appropriate.

#### Paragraph 11

The treatment of costs set forth is based generally on the Germany-United States and similar conventions. An alternative, simpler approach is to mandate an equal sharing of costs, as provided in Article 11(3) of the EU Convention. Subparagraph (b) is not contained in other models as taxpayer participation is not contemplated.

The Germany-United States convention includes a rule that provides that the taxpayer may be required to bear the costs of a Contracting State, and the taxpayer's agreement to bear the costs is a



prerequisite to arbitration. The draft Article does not retain this provision. Instead, subparagraph (d) provides that the arbitration board make a final determination as to costs.

#### Paragraph 12

This paragraph is intended to ensure that necessary modifications to the full gamut of procedural rules set out in the draft Article may be agreed to by the competent authorities without requiring a protocol to the convention. See, for example, the German-United States convention and Article 11(2) of the EU Convention. This complements the more limited right of the competent authorities to determine arbitration procedure before the board, in paragraph 5.

#### Paragraph 13

An important issue in tax arbitration is the effectiveness and enforceability of decisions of the arbitration board. This paragraph is based on the recommendations in the ICC Policy Statement. No such provision is found in the US conventions or the EU Convention. The implication of paragraph 13 is that the Contracting States will take such steps as may be necessary, including changes to domestic law, to implement the arbitration decision.

The EU Convention makes provision for alternative action by the competent authorities, not necessarily in accordance with the arbitration decision, so long as it eliminates double taxation. This has not been retained in the draft Article because it is contrary to the guideline established in the ICC Policy Statement to the effect that the double taxation should be eliminated applying legal principles.

No reference is made in paragraph 13 to the payment of interest. It is appropriate that interest should be paid if, under domestic law, this would be the case had the same action been taken by the tax authorities of the Contracting State without regard to arbitration.

**Document n° 180/455 Rev. 2**  
6 February 2002