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MANDATORY ARBITRATION OF INTERNATIONAL TAX DISPUTES: A SOLUTION IN SEARCH OF A PROBLEM

by

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Abstract

Improving the resolution of international tax disputes has witnessed recent developments. The Organization of Economic Development and Cooperation (“OECD”) amended its Model Convention and Commentary to include mandatory and binding arbitration of tax disputes between two treaty countries that have been unsuccessful in resolving the disputes through negotiations between their tax authorities. The United States has amended its income tax treaties with Belgium, Canada, Germany and France to include mandatory and binding arbitration of unresolved tax disputes. These amendments are undoubtedly an important step toward improving the resolution of international tax disputes. Nevertheless, the Article argues that these amendments fail to achieve this goal. By their terms, the amendments enable countries to avoid the arbitration. There is a risk these amendments will damage previously existing resolution methods that have generally been successful. The arbitration, as currently proposed, can be used by taxpayers to achieve abusive and undesirable tax results. The Article argues that these amendments will not serve the two primary goals income tax treaties aim at achieving which are preventing double taxation as well as double non-taxation (i.e., escaping taxation).

In Part one of the Article I present a brief overview of major contributions to the literature in this field. I set forth an evaluation methodology that focuses on two questions: First, does a mandatory arbitration provision fit in the overall network of tax treaties? Second, can the mandatory and binding arbitration provision actually resolve disputes? I argue that when we are able to answer positively to both questions, a recommendation to adopt such a provision will follow.

In Part two I focus on the OECD proposal for mandatory and binding arbitration aimed at improving the resolution of international tax disputes. I conclude that under the current proposed structure, a negative answer to the above evaluation questions is more likely to be given than a positive one. I address certain policy issues related to the proposal, structural deficiencies embodied in it as well as possible negative consequences it may have. I conclude that the proposal should be reexamined.

In Part three I examine the mandatory and binding arbitration provisions that were adopted recently in a few income tax treaties to which the United States is partner. I conclude that the United States expresses a position aimed at limiting the application of mandatory and binding arbitration.

Part four is a summary of the work. I explain that I generally do not oppose the adoption of mandatory and binding arbitration. Nevertheless, I offer some considerations regarding the circumstances accompanying the application of the proposed provisions as well as their structure. I suggest that the proposals should be reexamined because they lack features that are

major and crucial for successful mandatory and binding arbitration and because of the risk that they will negatively affect pre-existing dispute resolution mechanisms.

I. INTRODUCTION

A. *Arbitration of International Tax Disputes – General Background*

The issue at stake is the following: an income tax treaty (“ITT”), exists between two countries. If a taxpayer has connections to both countries, and if both tax administrations exert their authority to tax, the taxpayer will be subject to double taxation. This result is arguably undesirable and the ITT is aimed at preventing it. “Income tax treaties have two primary operational goals - to reduce the risk of double taxation to taxpayers engaged in cross-border transactions and to mitigate the risks of under-taxation of taxpayers by promoting cooperation and exchange of information among responsible members of the international family of nations.”¹

Perhaps a clear example of the above scenario is the *Boulez Case*.² The issue in the case was whether certain payments received by Pierre Boulez constituted royalties or compensation for personal services. Had the payments been characterized as royalties, they would have been exempt from U.S. tax. Had they been compensation for personal services, they would have been subject to U.S. tax. Under the U.S.-German ITT valid at that time the only dispute resolution mechanism available was the Mutual Agreement Procedure (“MAP”). The MAP Article in the ITTs is usually similar in its wording to Article 25 of the OECD Model Convention (MC).³ In the MAP,

1. Brian J. Arnold & Michael J. McIntyre, *International Tax Primer*, second edition, at 6. See also at 105:

The objective of tax treaties, broadly stated, is to facilitate cross-border trade and investment by eliminating tax impediments to these cross-border flows. This broad objective is supplemented by several more specific, operational objectives. The most important operational objective of bilateral tax treaties is the elimination of double taxation.

See also Stef van Weeghel, *The Improper Use of Tax Treaties*, Series on International Taxation No. 19, (Kluwer Law), (1998) at 33 addressing the two above mentioned objectives as major objectives and adding to them, as a third and major objective, the non-discrimination clause.

2. *Boulez v. Comm’r*, 83 T.C. 584 (1984).

3. Because of its relevance to the discussion I will cite the wording of Article 25 of the OECD Model Conventions which reads as follows: (1) Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under ¶ 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention. (2) The competent authority shall endeavour,

a taxpayer introduces its case to the relevant competent authority and if that competent authority cannot resolve the matter independently, the case will usually be negotiated between the competent authorities of the involved states in an attempt to settle the dispute. This is what happened in the *Boulez* Case. The dispute was referred to the competent authorities for resolution in an attempt to prevent double taxation of Boulez's income. The Competent Authorities of Germany and the U.S. were unable to reach an agreement regarding the characterization of the payments. Germany took the position that the payments were royalties and therefore taxable exclusively by Germany. The U.S. took the position that the income generated from the performance of personal services in the U.S. and therefore taxable there. Boulez was taxed on the same income twice.

This was the result, even though one of the primary purposes of the ITT was to prevent it. The MAP Article lacks the power to compel the competent authorities to resolve the dispute and grant relief to the taxpayer. The Article entails a quasi duty⁴ to endeavour to resolve the dispute in order to prevent taxation not in accordance with the ITT. Nevertheless, there is no obligation to actually settle the dispute. Therefore, there is no guarantee that one of the primary goals of the ITTs (preventing double taxation) will be met. Because of disputes similar to this, which remain unresolved after the MAP, the search for a solution accelerated. Mandatory arbitration has been introduced in this context.

More common disputes are transfer pricing disputes.⁵ In these disputes, a taxpayer with cross-border activity will try to allocate income and deductions in a tax favorable manner. The concerned tax administrations

if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States. (3) The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention. (4) The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs.

4. See part two of the paper for discussion regarding the scope of this duty and the controversies as to its existence.

5. See Report to The Congress on Earning Stripping, Transfer Pricing and U.S. Income Tax Treaties, available at <http://www.ustreas.gov/offices/tax-policy/library/ajca2007.pdf> noting that a substantial portion of the inventory of the U.S. Competent Authority consists of cases that involve transfer pricing agreements.

may disagree with the taxpayer's allocation and levy tax based on an adjusted allocation. This in turn may cause potential double taxation. If the taxpayer regards the taxation not in accordance with the ITT, it can seek relief either at the domestic level or by utilizing the MAP.

B. Do We Really Need Arbitration?

The need for a mandatory and binding dispute resolution mechanism seems evident. It is clear, however, that implementing such an option will be accompanied with tradeoffs the major of which is accepting the binding authority of an arbitral panel and surrendering tax sovereignty. This dilemma has long occupied proponents and opponents of mandatory and binding arbitration and due to this concern, mandatory and binding arbitration has not been considered a feasible option.

One of the relevant and basic works in this field was that of Lindencrona and Mattsson in 1981.⁶ The authors present an overview of the work of international professional organizations up to that date and examine the manner in which international arbitration functions in other fields. If to be extremely brief, they acknowledged that under the then-existing ITTs, avoiding double taxation was not guaranteed and therefore recommended adopting a mechanism that would ensure a solution in all cases.⁷ Despite the logic upon which this recommendation lies, it was not praised by the vast majority of countries who in fact have not adopted arbitration clauses in their ITTs to this day. The OECD Committee on Fiscal Affairs (1984) released a report noting:

The Committee does not, for the time being, recommend the adoption of a compulsory arbitration procedure to supersede or supplement the mutual agreement procedure. In this view the need for such compulsory arbitration has not been demonstrated by evidence available and the adoption of such a procedure would represent an unacceptable surrender of fiscal sovereignty.⁸

6. Gustaf Lindencrona & Nils Mattsson, *Arbitration in Taxation* (1981).

7. *Id.* at 17. The authors state that:

“If two states have decided to conclude an agreement on the avoidance of double taxation, they have thereby accepted to refrain from their right of taxation in certain situations. It is only logical that the states find solutions that ensure that disputes on the contents of the agreement can be solved in all situations.”

8. OECD, *Transfer Pricing and Multinational Enterprises: Three Taxation Issues*, (1984). See also Karl Koch, *Mutual Agreement-Procedure and Practice*, LXVIa *Cahiers de droit fiscal international* 109, General Report to the IFA Congress (1981), at 125: “Although there has long been a call for the creation of arbitration

Despite this concern, many scholars and non-governmental organizations have suggested mandatory arbitration as a means to address international tax disputes.⁹ I agree that an effectively functioning mandatory and binding arbitration provision that meets the goals of the ITT network would constitute an appropriate solution. Whether the current proposals fall within this framework or not is discussed below.

The question addressed in this sub-chapter could be approached in a different manner. Defenders of mandatory arbitration point to the prevention of double taxation as the primary justification for adopting it. They argue that improving taxpayer protection in international tax matters will facilitate cross-border transactions and flow of capital and investment. Potentially subjecting taxpayers to double taxation, they continue, will affect their investment choices leading to a distortion that ultimately causes inefficiencies. The mandatory and binding arbitration is therefore offered by them to combat this defect.

This analysis is logical assuming the unresolved cases are double taxation cases. Yet this assumption is not free from doubts.¹⁰ Because of the secrecy of MAP in general, and the lack of detail as to why some disputes remain unresolved and what the nature of the disputes were in particular, the process of evaluating whether or not the mandatory arbitration provision is necessary is more complicated.

To illustrate this point assume that all unresolved MAP cases are double non-taxation cases, i.e. had the taxpayer's position been adopted, the income would have been under-taxed or even subjected to no tax at all. Further assume that one of the competent authorities was unwilling to settle the dispute through MAP in order to prevent the no-tax result. In this case, the "preventing double taxation" argument in favor of mandatory and binding arbitration is lost because the taxpayer has not been subjected to double taxation. This distinction will be relevant to the analysis and the evaluation of the proposals. In the same manner that preventing double

procedure or an international court for tax matters, the opposition is probably too strong." For further discussion on fiscal sovereignty see generally Ramon J. Jeffery, *The Impact of State Sovereignty on Global Trade and International Taxation*, Series of International Taxation No. 23, (Kluwer Law), (1999). See also William W. Park & David R. Tillinghast, *Income Tax Treaty Arbitration (Sdu Fiscal)*, (2004). See also Tax Notes International's interview with Carol Danahoo, former U.S. IRS Competent Authority, available at LEXIS (2004 WTD 12-5) (Jan. 19, 2004). See also Kevin Bell, *Germany-U.S. Tax Treaty Arbitration Process Addresses Sovereignty Issue*, 43 *Tax Notes Int'l* 214 (Jul. 17, 2006).

9. See William W. Park, *Income Tax Treaty Arbitration*, *Tax Mgmt. Int'l J.* 31(5), 219 and the references thereafter. See also Park & Tillinghast, *supra* note 8.

10. See Michael McIntyre, *Comments on the OECD Proposal for Secret and Mandatory Arbitration of International Tax Disputes*, 7 *Fla. Tax Rev.* 622.

taxation can benefit the public, preventing double non-taxation has a similar positive effect. Double non-taxation causes economic distortions as well. If the unresolved cases are double non-taxation cases, this may question the need for a mandatory and binding arbitration provision.

C. *Defining the Goals of Arbitration in the International Tax Arena:*

In 1927 The League of Nations took the following position:¹¹

From the very outset, the Committee realized the necessity of dealing with questions of tax evasion and double taxation in co-ordination with each other. It is highly desirable that States should come to an agreement with a view to ensuring that a taxpayer shall not be taxed on the same income by a number of different countries, and it seems equally desirable that such international co-operation, should prevent certain incomes from escaping taxation altogether. The most elementary and undisputed principles of fiscal justice, therefore, required that the experts should devise a scheme whereby all incomes would be taxed once, and once only.

This principal is referred to in the literature as the “Single Tax Principal” and apparently, it enjoys the support of many countries, academics and organizations.¹² This is the OECD’s position as well.¹³ This principal is a

11. See League of Nations, *Double Taxation and Tax Evasion – Report presented by the Committee of Technical Experts on Double Taxation and Tax Evasion*, League of Nations Doc. G. 216 M. 85. II (Geneva, April 1927). See also Cole, Venuti, Gordon and Croker, *Income: Income Tax Treaties – Administrative and Competent Authority Aspects*, 940 T.M., at A-1: “The most important functions (of tax treaties) are (i) to avoid double taxation of income ... (iii) to assist in the prevention of tax avoidance and tax evasion.”

12. See generally Reuven Avi-Yonah, *International Tax as International Law*, Law & Economics Working Paper Series, 7-13 (2004). See also Reuven Avi-Yonah, *International Tax as International Law-An Analysis of the International Tax Regime*, Cambridge Tax Law Series, (2007) at 8:

Income from cross-border transactions should be subject to tax once (i.e., neither more nor less than once). The single tax principle thus incorporates the traditional goal of avoiding double taxation, which was the main motive for setting up the international tax regime in the 1920s and 1930s. Taxing cross-border income once also means, however, that it should not be under-taxed or (at the extreme) be subject to no tax at all.

manifestation of the two identified primary goals of the ITTs: preventing double taxation as well as double non-taxation. I believe that the mandatory and binding arbitration provisions, as an inherent part of the treaties, should participate in fulfilling these primary goals.¹⁴ In order for this to be possible, the provision should meet a two-part evaluation test. First, it should fit within the overall ITT network which basically means that the provision should facilitate achieving these primary goals. Second, the provision should be able to function in a manner that resolves disputes. The first part of this test addresses a legal concern and the second part is a technical one. The success of a mandatory and binding arbitration provision is dependent on meeting both parts of this test.

See also Joint Committee on Taxation, Testimony of the Staff of the Joint Committee on Taxation before the Senate Committee on Foreign Relations Hearing on the Proposed Tax Treaty with Belgium and the Proposed Tax Protocols with Denmark, Finland, and Germany (JCX-51-07), (Jul. 17, 2007), Thomas A. Barthold, Acting Chief of Staff of the Joint Committee on Taxation, stated that: "The principal purposes of the treaty and protocols are to reduce or eliminate double taxation of income earned by residents of either country from sources within the other country and to prevent avoidance or evasion of the taxes of the two countries."

13. See OECD, Commentary on the Articles of the 2005 OECD Model Income and Capital Tax Convention (Jul. 15 2005), Commentary on Article 1, ¶ 7 titled: "Improper use of the Convention" states that:

7. The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons. It is also a purpose of tax conventions to prevent tax avoidance and evasion. 7.1 Taxpayers may be tempted to abuse the tax laws of a State by exploiting the differences between various countries' laws. Such attempts may be countered by provisions or jurisprudential rules that are part of the domestic law of the State concerned. Such a State is then unlikely to agree to provisions of bilateral double taxation conventions that would have the effect of allowing abusive transactions that would otherwise be prevented by the provisions and rules of this kind contained in its domestic law.

14. Many other goals of the ITTs have been identified but I chose to focus on these two as they are the primary goals. For an exhaustive discussion see Zvi D. Altman, *Dispute Resolution under Tax Treaties*, Volume 11, Doctoral Series, (IBFD, 2005). See generally Michael Lang and Mario Züger, *Settlement of Disputes in Tax Treaty Law* (EucoTax, 2003), Mario Züger, *Arbitration under Tax Treaties*, Volume 5, Doctoral Series, (IBFD, 2001). See also Henry J. Brown and Arthur L. Marriot Q.C., *ADR Principles and Practice*, 2nd edition, (Sweet & Maxwell) (1999).

II. THE OECD PROPOSAL FOR MANDATORY AND BINDING ARBITRATION

A. *The OECD Proposal: Overview*

A few years ago the OECD launched a project aimed at improving the resolution of international tax disputes the outcome of which has been included in a final report that was released in 2/2007. The project was focused on enhancing the MAP under Article 25 of the OECD MC while simultaneously including a mechanism that will ensure a final, definite and binding resolution of disputes.¹⁵ There was a previous version to this report and the basic change, according to the OECD, between the draft from 2/2006¹⁶ and the final report mainly reflects the decision not to require a waiver of domestic remedies as a condition for initiating the arbitration process.¹⁷

In this part of the Article I wish to evaluate the structure of the proposed provision. I argue that the proposed structure has a “built-in” flaw which, in certain circumstances, can defeat the idea of having mandatory and binding arbitration as a final resort for the resolution of disputes. In addition I argue that the proposal (as currently structured) can negatively damage the MAP which it was originally aimed at improving. A few recent commentaries address the OECD proposal and offer some suggestions for its improvement.¹⁸ I generally agree with these suggestions. Yet I will tackle the proposal from a structural point of view.

The OECD proposal adds paragraph 5 to the existing Article 25 of the OECD MC:

15. See OECD official website at <http://www.oecd.org/dataoecd/17/59/38055311.pdf> for the full report “Improving the resolution of tax treaty disputes,” Report adopted by the Committee on Fiscal Affairs on 30 Jan. 2007, Feb. 2007 (hereinafter “the OECD report”).

16. See OECD official website at <http://www.oecd.org/dataoecd/5/20/36054823.pdf> for the full version: “proposals for improving mechanisms for the resolution of tax treaty disputes,” Public Discussion Draft, (Feb. 2006), (hereinafter “the 2006 OECD report”).

17. See the OECD report, *supra* note 15 ¶ 15.

18. See McIntyre, *supra* note 10. See also Marcus Desax and Marc Veit, *Arbitration of Tax Treaty Disputes: The OECD Proposal*, *Arb. Int'l* 23:3 (2007), 405. See also James Morgan, *New Developments in the Resolution of International Tax Disputes*, 43 *Tax Notes Int'l* 77 (Jul. 3, 2006).

5. Where,

a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and

b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the presentation of the case to the competent authority of the other Contracting State,

any unresolved issues arising from the case shall be submitted to arbitration if the person so requests. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.¹⁹

To trigger the mandatory and binding arbitration under the proposal, the competent authorities of both countries must first negotiate the dispute through MAP. If they are unable to settle the dispute within two years, the mandatory and binding arbitration can be triggered upon taxpayer's request. In other words, the arbitration is an extension of the MAP and not an independent procedure.²⁰

19. See the OECD report, *supra* note 15, at 5.

20. See the OECD report, *supra* note 15, the proposed commentary on the new paragraph provides that:

The paragraph is, therefore, an extension of the mutual agreement procedure that serves to enhance the effectiveness of that procedure by ensuring that where the competent authorities cannot reach an agreement on one or more issues that prevent the resolution of a case, a resolution of the case will still be possible by submitting those issues to arbitration. Thus, under the paragraph, the resolution of the *case* continues to be reached through the mutual agreement procedure, whilst the resolution of a particular *issue* which is preventing agreement in the case is handled through an arbitration process. This distinguishes the process established in ¶ 5 from other forms of commercial or

B. What is the Mutual Agreement Procedure (MAP)?

In order to better understand the proposal, especially because of the manner in which it was structured, a few words addressing the scope and nature of the MAP are necessary. The MAP is a mechanism utilized in cases where a dispute regarding the application or interpretation of a ITT arises between two Contracting States usually upon taxpayer's request. The intention is to enable the Contracting States to reach a settlement which would help improve the fiscal relationship between the competent authorities and provide better taxpayer protection.

The MAP is part of a diplomatic process manifested in the bilateral negotiations between two governments that maintain their status as the decision makers. They decide to what extent to release fiscal sovereignty, which cases are suitable to be negotiated and whether or not to settle. The basic feature of MAP, and the most widely criticized, is that the parties are under no obligation to resolve a dispute.

C. What is the Case When no MAP Was Set in Motion?

An inevitable question is whether the wording of the proposed paragraph 5(b) "the competent authority are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the presentation of the case to the competent authority of the other Contracting State" includes a situation where the competent authorities do not commence negotiations at all. In other words, if the two year period elapses yet no MAP negotiations commence, will the mandatory and binding arbitration be triggered? Based on the wording of the proposed paragraph the answer should be no. I take this position for the following reasons: First, the arbitration is clearly structured as an extension of the MAP. The intention is for the arbitration to be triggered only after both competent authorities were unable to settle through the MAP. Paragraph 12 of the OECD report²¹ states that:

Recourse to these techniques, however, must be an integral part of the mutual agreement procedure and should not constitute an alternative route to solving tax treaty disputes between States, which would risk undermining the effectiveness of the mutual agreement procedure.²²

government-private party arbitration where the jurisdiction of the arbitral panel extends to resolving the whole case.
(emphasis in original).

21. See the OECD report, supra note 15.

22. Id., ¶ 46.

Second, from the proposed paragraph 46 to the commentary²³ it is clear that there is a distinction between the “case” and the “issue.” This paragraph addresses a hypothetical situation where the competent authorities are unable, during the negotiations, to resolve one or more issues and are therefore unable to resolve the case in whole. In such circumstances, the proposed paragraph would cause the unresolved issues to be resolved through the mandatory and binding arbitration, leaving the resolution of the case to be achieved through MAP.²⁴ Here too the assumption is that the negotiations have already commenced.

Third, paragraph 50 of the proposed commentary clarifies that its application is conditioned upon the availability of MAP:²⁵

Where the mutual agreement procedure is not available, for example because of the existence of serious violations involving significant penalties, it is clear that paragraph 5 is not applicable.

Fourth, mandatory and binding arbitration is triggered under the proposal when the parties were unable to settle *pursuant to paragraph 2*. Paragraph 2 (of Article 25) deals with the MAP negotiations. The referral to paragraph 2 in this case emphasizes that exhausting the MAP negotiations is a condition to triggering the arbitration.

D. Is There a Duty to Negotiate? Various Positions

Because of the manner in which the proposal was structured, the question whether or not a duty to initiate MAP exists directly affects the operation of the provision. As clarified above, commencing the MAP is a condition to triggering the arbitration. If the competent authorities are under no duty to participate in MAP negotiations, this could create a tool that could be utilized to prevent triggering the arbitration. By denying a request to commence MAP negotiations, the competent authority will never be subject to mandatory and binding arbitration.²⁶

23. *Id.*, ¶ 16.

24. *Id.*, ¶ 46 of the commentary in ¶ 16.

25. *Id.*, ¶ 16.

26. See § G(1) below for a deeper discussion on this point.

1. The OECD View

The OECD takes the view that the competent authorities are under a duty to initiate MAP upon request from the taxpayer.²⁷ In my mind this position is problematic, let alone contrary to the language of Article 25. Article 25(2) implies that the so called “duty to negotiate” is not unconditioned. The Article poses two conditions once met, will presumably establish a duty, or better say a quasi duty, to “endeavour” to resolve the case by mutual agreement. The first condition is: “if the objection appears to it to be justified.” The second condition is: “if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority.” If a competent authority considers a taxpayer’s objection *not* justified, the first condition is not met and the “duty” to negotiate is therefore not established.

The OECD commentary is inconsistent. Paragraph 20 of the commentary²⁸ provides that:

The provisions of paragraph 1 give the taxpayer concerned the right to apply to the competent authority of the State of which he is a resident ... that competent authority is under an obligation to consider whether the objection is justified and, *if it appears to be justified*, take action on it in one of the two forms provided for in paragraph 2.

Paragraph 23 of the commentary states:

An application by a taxpayer to set the mutual agreement procedure in motion should not be rejected *without good reason*.²⁹

The commentary is not clear on this issue. What constitutes “a good reason” to deny a MAP request? Paragraph 22 addresses a situation where the taxpayer approaches the resident competent authority and “if it appears to that competent authority that the taxation complained of is due wholly or in

27. See OECD, Commentary on the Articles of the 2005 OECD Model Income and Capital Tax Convention (Jul. 15, 2005), Commentary on Article 25, ¶ 26, stating that: “Paragraph 2 no doubt entails a duty to negotiate; but as far as reaching mutual agreement through the procedure is concerned, the competent authorities are under a duty merely to use their best endeavours and not to achieve a result.”

28. See OECD, Commentary on the Articles of the 2005 OECD Model Income and Capital Tax Convention (Jul. 15, 2005), Commentary on Article 25, ¶ 20. (emphasis added).

29. *Id.*, ¶ 23. (emphasis added).

part to a measure taken in the other State, it will be incumbent on it, indeed it will be its duty – as clearly appears by the terms of paragraph 2 – to set in motion the mutual agreement procedure proper.”³⁰ To set in motion the MAP, at this stage, means that the “resident” competent authority approaches the “source” competent authority with the potential taxation not in accordance with the ITT. The “resident” competent authority is under a duty – established in paragraph 22 of the commentary – to do so. The “source” competent authority, in return, is also obliged to set the MAP in motion. This is established by paragraph 26. Yet the duty imposed upon the “resident” competent authority (initially approached by the taxpayer) is subject to the taxpayer’s objection being justified. Paragraph 23 of the commentary makes this clear. The same could be argued regarding the “source” competent authority. It too must consider taxpayer’s objection justified. Nevertheless, paragraph 26 emphasizes that paragraph 2 no doubt entails a duty to negotiate. This confusion does not contribute to the discussion. It seems difficult, therefore, to reconcile between these different approaches.³¹

One commentator, Richard Hammer, believes that:

Paragraph 1 (of Article 25) provides the taxpayer with the right to seek CA intervention, whether or not the taxpayer has yet exhausted all his legal remedies in his home country. Paragraph 2 then refers it *to the judgment of the relevant CA to decide whether or not the case is of sufficient merit* for pursuance by the CA. If the complaint is justified, the CA to which the appeal was directed (generally the CA of the country of residence or citizenship of the complainant) is obliged to trigger off the mutual agreement procedure mechanism, which of course involves government to government negotiations.³²

30. *Id.*, ¶ 22.

31. An additional issue that should be pointed out is that the commentary is not as emphatic, regarding the interpretive and legislative MAP under ¶ 3, as under ¶¶ 1 and 2 of Article 25. See ¶ 32 of the commentary stating that the first sentence of the ¶ 3 of Article 25 invites and authorizes the competent authorities to resolve, if possible, difficulties of interpretation or application by means of mutual agreement. In one case the OECD sees a “duty” and in the other only an “invitation.”

32. Richard Hammer, Introduction to Competent Authority, in New York University, International Institute on Tax and Business Planning, (1977), at 171. (emphasis added).

According to this view, which strikes me as reasonable, it is up to the competent authority to judge whether or not the case is of sufficient merit.³³ Pierre Kerlan, former Director of International Tax Affairs in France, went beyond and questioned whether Article 25(2) could oblige the competent authority to initiate MAP, even assuming that taxpayer's objection is justified.³⁴ Jon Bischel notes that:

Yet, to be truly effective, some alterations are essential to existing competent authority structures. For instance, the present procedure is voluntary since a competent authority to which a claim is presented may refuse to consider the request if it determines it meritless.³⁵

2. *The U.S. View*

The U.S. tax authorities are required to notify the taxpayer whether or not the case is suitable for consideration under MAP.³⁶ The flip-side of this requirement is that some cases are not suitable for MAP. Previously, it was possible for a taxpayer to request review of the decision not to initiate MAP.³⁷ This review option was decreased by Rev. Proc. 79-32³⁸ and

33. See also *Id.*, at 177, he states: "From the U.S. taxpayer's point of view, there are several weaknesses in the CA procedure. First of all, the IRS has *the sole right* to decide if a case is meritorious and if it should go to CA. The taxpayer has no right to appeal an adverse determination on this question." (emphasis added).

34. Pierre Kerlan, *International Disputes With Respect to Tax Conventions – The French View*, in New York University, *International Institute on Tax and Business Planning* (1977), *supra* note 32, at 232.

35. Jon E. Bischel, *Tax Allocations Concerning Inter-Company Pricing Transactions in Foreign Operations: A Reappraisal*, 13 *Va. J. Int'l L.* 490 at 514. See also Adrian A. Kragen, *Avoidance of International Double Taxation Arising From § 482 Reallocations*, 60 *Cal. L Rev.* 1493 at 1514 arguing in favor of this argument.

36. See Matthew T. Adams, *The Procedure for Invoking Competent Authority Assistance Under United States Income Tax Treaties*, in New York University, *International Institute on Tax and Business Planning*, (1977), *supra* note 32 at 188.

37. Rev. Proc. 77-16; 1977-1 C.B. 573, § 6.03. The Rev. Proc. provides that: "The decision of the review panel as to whether competent authority assistance should be provided is not further reviewable within the Service. (However, the taxpayer may pursue all rights to judicial review of the review panel's decision under the laws of the United States.)"

38. Rev. Proc. 79-32; 1979-1 C.B. 599, § 3.02 amended § 6.03 of Rev. Proc. 77-16 by making the decision of the review panel designated by the Internal Revenue Commissioner final and omitting the part granting right for judicial review of the reviewing panel's decision under U.S. laws. It could be argued though that the

abolished completely by Rev. Proc. 91-23.³⁹ These modifications indicate the U.S. position as to taxpayers' rights (and competent authority's obligation) to initiate MAP.

The omission of the right to request review of the competent authority's decision was coupled with an increase in the number of circumstances in which the competent authority could deny MAP assistance. Rev. Proc. 77-16 enumerated three such circumstances while Rev. Proc. 2006-54 enumerates eight.⁴⁰ For example, the competent authority can classify a case as unsuitable for MAP consideration or assistance if the taxpayer is willing to accept a settlement under conditions that are unreasonable or prejudicial to the interests of the U.S. government.⁴¹ Authority to deny MAP assistance is also granted where the competent authority believes that the transaction giving rise to the request for competent authority assistance is more properly within the jurisdiction of IRS appeals or is designated by the IRS for litigation.⁴²

Other commentators acknowledge that Article 25 does not entail a duty upon the competent authorities to commence the negotiations while taking the position that this should be revised.⁴³ In presenting some of the

judicial review is still available despite the fact that the sentence granting this review was omitted.

39. Rev. Proc. 91-23; 1991-1 C.B. 534, § 1 pointed out that: "Rev. Proc. 82-29, 1982-1 CB. 481, and Rev. Proc. 77-16, 1977-1 C.B. 573, as amplified by Rev. Proc. 79-32, 1979-1 C.B. 599, are superseded by this revenue procedure." In § 11.04 the Rev. Proc. 91-23 read: "Review of Denial of Request for Assistance. The U.S. competent authority's denial of a taxpayer's request for assistance or dismissal of a matter previously accepted for consideration pursuant to this revenue procedure is final and not subject to administrative or judicial review." Rev. Proc. 2006-54; 2006 I.R.B. 1035, which is valid to date, states, in § 12.04 that: "The U.S. competent authority's denial of a taxpayer's request for assistance or dismissal of a matter previously accepted for consideration pursuant to this revenue procedure is final and not subject to administrative review."

40. See § 12.02 of Rev. Proc. 2006-54, *supra* note 39.

41. See § 12.02 (2) of Rev. Proc. 2006-54, *supra* note 39.

42. See § 12.02 (8) of Rev. Proc. 2006-54, *supra* note 39. See also Paul C. Rooney and Nelson Suit, *Competent Authority*, 49 *Tax Law* 675, at 681: "Moreover, the competent authority procedure, by stating that assistance may be denied if the case has been "designated for litigation" by the Service, shows the manner in which the Service would appear to retain discretion to litigate a case rather than allow it to proceed through the competent authority process."

43. See John F. Avery Jones et al., *The Legal Nature of the Mutual Agreement Procedure Under the OECD Model Convention-I*, [1979] *Brit. Tax Rev.* 333 at 337, citing Pierre Kerlen, *supra* note 34, arguing that the question whether competent authorities are under an obligation to refer the matter to the other competent authority, or merely under a recommendation to do so, is disputed by some states.

technical and practical problems associated with MAP negotiations, Sanford Goldberg deals with the procedural aspects of the MAP and he also acknowledges these limitations.⁴⁴ John F. Avery Jones and others proposed procedural improvements to the MAP acknowledging that:

At present the taxpayer's only right is to present his case to the competent authority of the State of which he is resident (or in some cases of which he is a national). After that, the matter is outside his control in a way which does not happen in litigation. *He cannot force his competent authority to take the matter up with the other competent authority*, and, even if it does so, the taxpayer does not know how strongly it will press his case.⁴⁵

Arvid Skarr has expressed a similar opinion.⁴⁶ Referring to Article 25(2) of the OECD MC, he notes that the taxpayer's rights depend upon the discretionary assessment of the competent authority of his state of residence.⁴⁷

The General Report presented to the International Fiscal Association (IFA) Congress in 1981⁴⁸ addressed this issue as well. In reviewing the several reasons for refusal to grant competent authority assistance, the report makes clear that:

The taxpayer has no legal right to require implementation of mutual agreement procedure (except in Belgium), but solely

44. Stanford H. Goldberg, *How and Does the Competent Authority Work?* 39 *Tax Executive*, 1985-87, 3. He points out that a request for MAP may be denied for substantive or procedural reasons.

45. See John F. Avery Jones et al., *The Legal Nature of the Mutual Agreement Procedure Under the OECD Model Convention-II*, [1980] *Brit. Tax Rev.* 13, at 19. (emphasis added).

46. Arvid Aage Skaar, *The Legal Nature of Mutual Agreements Under Tax Treaties*, 5 *Tax Notes Int'l* 1441 (1992). See also Zvi D. Altman, *supra* note 14 at 272. He enumerates the disadvantages of the MAP and notes that: "Another very important disadvantage of the MAP concerns the unlimited discretion given to the competent authority in deciding which cases to accept and which to reject."

47. *Id.*, at 1447. In elaborating the question whether or not a taxpayer's claim is justified, he points out that: "Unfortunately, the authorities of different countries have different policies concerning what makes it "justified" to initiate mutual agreement procedure. From the taxpayer's point of view, the most frightening aspect of this procedure is that the competent authorities may refuse to institute the mutual agreement procedure simply because they disagree with the taxpayer."

48. See Koch, *supra* note 8.

a right to require that the competent authority should decide, within the scope of its due discretion, whether mutual agreement procedure should be started.⁴⁹

It is also noteworthy that the U.S. commentary does not contain a paragraph similar to paragraph 26 of Article 25 of the OECD MC, which states that a duty to negotiate exists, and this is in-line with the United States' position.

Considering the above commentary and the changes in the Revenue Procedures throughout the past thirty years it seems conceivable to argue that from the United States' perspective, competent authority assistance is granted at the discretion of the tax authority and there is no duty to grant it. This position was upheld by the District Court in *Yamaha Motor Corp. v. United States*.⁵⁰ Yamaha sought a declaratory judgment that the Service wrongfully refused its request for MAP assistance under the ITT and to compel the Service to consider this request.⁵¹ The IRS filed a motion to dismiss and the court granted the motion holding that it lacked jurisdiction to review the determination.⁵² In denying Yamaha's plea the court noted:

First, it is *entirely possible* that the Government could prevail in its attempt to prevent Plaintiffs from immediate access to negotiations via the Treaty. For example, the *Government could decide that the Plaintiffs' double tax claim has no merit, and could deny the request*.⁵³

In *Filler v. Comm'r*,⁵⁴ a similar decision, denying the court's jurisdiction to initiate competent authority proceedings, was granted.⁵⁵ The court characterizes the MAP as an international administrative procedure between the competent authorities of the contracting states rather than a procedure. These decisions have not escaped the criticism of some

49. *Id.*, at 109.

50. 779 F. Supp 610 (D.D.C. 1991).

51. *Id.* at 611.

52. *Id.*

53. *Id.*, at 613. (emphasis added).

54. 74 T.C. 406 (1980).

55. *Id.* at 407-408: ("We hold that Article 25, which establishes a certain procedural device for dealing with rights agreed upon in the convention, does not afford petitioner a remedy which can be asserted in this Court.") See also American Law Institute, *International Aspects of United States Income Taxation II, Proposals on United States Income Tax Treaties*, 1991 A.L.I. Fed. Income Tax Project 99 (May 13). "In the United States, a claim for relief under Article 25, ¶ 1 may not be asserted in court, but may only be made to the competent authority." (citing *Filler*, 74 T.C. at 408).

commentators.⁵⁶ Nevertheless, they are valid and support the policy of the U.S. tax authorities as reflected in Rev. Proc. 2006-54.

3. *The Canadian View*

The Canada Revenue Agency (CRA) has issued Information Circular 71-17R5 Guidance on Competent Authority Assistance Under Canada's Tax Conventions which is valid to date.⁵⁷ Paragraph 12 of the Information Circular provides:

Where a request is made to the Canadian Competent Authority under the MAP article of a tax convention, the Canadian Competent Authority will first, if the request appears to be justified and can be accepted by the Canadian Competent Authority from a policy standpoint, attempt to resolve the matter unilaterally.

Section 24 of the Information Circular, dealing with the acceptability of requests, enumerates 4 circumstances in which the Canadian Competent Authority will accept a request for assistance, the last of which is that the issue is not one that the Canadian and/or the foreign Competent Authority have decided, *as a matter of policy*, not to consider. This indicates that CRA has discretion to deny certain MAP requests.

56. See Rooney & Suit, *supra* note 42, at 696-700 (arguing that the *Yamaha* decision was wrongful and that there should exist a judicial review mechanism that would ensure taxpayer rights to initiate MAP proceedings and provide judicial review for the Service's decision whether or not to commence MAP negotiations). See also Sanford H. Goldberg & Seth B. Goldstein, U.S. District Court Lacks Jurisdiction to Compel IRS to Consider Request for Competent Authority Assistance, 40 Can. Tax J., 1009, 1015 (1992), (arguing that the U.S. position violates many treaties and that the *Yamaha* decision is very disturbing). See also Stanford H. Goldberg and Peter A. Glicklich, Treaty-Based Nondiscrimination: Now You See It Now You Don't, 1 Fla. Tax Rev. 51, 57 (1992) ("Nor is it clear that a U.S. taxpayer can compel the Internal Revenue Service to participate in negotiations under the competent authority procedure.")

57. Information Circular 71-17R5 is available at <http://www.cra-arc.gc.ca/E/pub/tp/ic71-17r5/ic71-17r5-e.pdf>. This circular replaced Information Circular 71-17R4 dated May 12, 1995. Section 25 of Information Circular 71-17R5 provides:

"The CRA will notify the taxpayer in writing whether the Canadian Competent Authority has accepted or declined the request for competent authority assistance normally within thirty days of receiving a complete request. The taxpayer will be provided with the reasons for the decision where a request is declined."

In a 1998 article, Claude Lemlin and Regina Deanehan acknowledge that such authority for denial of MAP assistance, on both the Canadian and U.S. sides exists. They refer to Information Circular 71-17R4 and Rev. Proc. 96-13, 1996-1 C.B. 616 which were valid at time.⁵⁸ This view was also presented by the National Reporter of Canada in the 1981 International Fiscal Association Congress on Mutual Agreement – Procedure and Practice.⁵⁹

4. *The German View*

Klaus Vogel points out that the competent authority must first of all determine whether the taxpayer's assertion that he has been taxed contrary to the treaty is justified. The authority is duty bound by Article 25 to make that determination.⁶⁰ In other words, the obligation upon the competent authority is to determine whether the objection is justified, rather than to proceed to the negotiations. It is clear, however, that this is a two-step process in which the competent authority considers whether the taxpayer's objection is justified and whether the taxation complained of is – wholly or partly –

58. See Claude Lemelin and Regina Deanehan, *The Competent Authority Process: A Canadian And US Comparative Analysis*, 46 *Can. Tax J.* 657 (1998) at 664-665. See also Catherine Brown, *The U.S.-Canada Tax Treaty: Its Impact On the Cross Border Transfer of Technology*, 9 *Transnat'l Law.* 79 at 117:

Relief from double taxation can be sought through the mutual agreement procedure. To access this procedure, taxpayers must request competent authority assistance from their government. Approval can be denied, and has been in the United States in at least one recent instance. The Canadian government will also refuse to act for a number of reasons, including whether the issue is one the competent authorities of each jurisdiction may not agree to accept, or where the foreign government refuses to deal with the case.

59. See Koch, *supra* note 8, at 122. The article presents the various positions that were taken regarding the suggestion to improve the mutual agreement procedure by, *inter alia*, giving taxpayers a legal right to require initiation of mutual agreement procedure or in the event of refusal to appeal to the domestic courts. The article goes on to note:

The National Reporters for Austria, Canada, Japan and Norway do not regard improvements as necessary, expressing substantial doubts in this respect. In the view of the National Reporter for Canada, such measures would strike at the very root of the consensual nature of mutual agreement procedure, and could also result in appeals to the courts beyond those provided by the domestic legislation.

60. See Klaus Vogel, *Double Taxation Conventions*, 3rd Edition (1998), at 1366.

attributable to actions of the other contracting State. If so, it will endeavour to set a mutual agreement in the narrower sense in motion.⁶¹ The question is whether the taxpayer has the right to demand that the competent authority properly use its discretionary powers when deciding to set a MAP in motion. Vogel indicates that:

According to BFH [abbreviation for Bundesfinanzhof, (the supreme tax court of the Federal Republic of Germany), rulings, the competent authority has on the other hand the power of discretion to decide whether or not to allow the objection and consequently to set the mutual agreement procedure in motion *even when* the taxation complained of has been *proved* to be contrary to the Convention.⁶²

Either way, it is clear that the Competent Authority of Germany has *no duty* to initiate MAP negotiations. Furthermore, under the German Federal Fiscal Court rulings, MAP initiation authority is entirely committed to the discretion of the competent authority, even in cases where it has been proven that the subject taxation is not in accordance with the ITT. Jacob Friedhelm and others agree with the view that taxpayers have no right to require the German tax authorities to pursue MAP.⁶³ Peter Dehnen and Silke Bacht also present a similar position.⁶⁴

61. *Id.*, at 1367 (citations omitted).

62. *Id.*, at 1367. (emphasis in original).

63. Jacob Friedhelm, et. al, Hand Book On The 1989 Double Taxation Convention Between the Federal Republic of Germany and the United States of America, International Bureau of Fiscal Documentation, at 15, on Article 25, citing also § 3.3.1 of BStBl 1997 I (Administrative Principles published by the Federal Ministry of Finance in Germany).

64. Peter H. Dehnen and Silke Bacht, Compatibility of the Recent OECD Proposals with Germany's Tax Dispute Resolution Mechanism, Bull. for Int'l Fiscal Documentation 463 (Nov. 2006), at 466, under the discussion about the ITT between Germany and Sweden stating that: "... none of the tax treaties obliges the contracting states to start MAP. And, while German national law gives taxpayers the right to appeal against the tax administration's refusal to start a MAP, the higher courts are only allowed to ascertain whether the tax administration's decision was within its discretionary authority." See also: May a Taxpayer Force the Use of a Mutual Agreement Procedure, 23 European Taxation 195, dealing with the same case, at 198 (arguing that the tax authorities to whom the request is made may also base their decisions on reasons of suitability or convenience). See also Peter H. Dehnen, Germany Updates Mutual Agreement Procedure, 44 Tax Notes Int' 10 (Oct. 2, 2006).

5. *The Israeli view*

The Unit for International Taxation in Israel issued MAP guidelines in Executive Instruction 23/2001 that deal with the mutual agreement procedures.⁶⁵ Section 5.1 states that the competent authority will consider the application for MAP assistance and whether or not it could be justified. If the competent authority considers the assistance request not justified, it will notify the taxpayer of its decision in writing.

This position was upheld in a District Court decision in Israel.⁶⁶ Jeteck Technologies Ltd., a company resident in Israel, carried on a business in software production and development. Jeteck had an agreement with a Japanese company whereby it would sell to the Japanese company the right to use its computer software in return for royalties. The Japanese company withheld tax from the payments it made to the Jeteck. Jeteck claimed a tax credit in Israel for the taxes withheld in Japan. The Israeli tax authorities denied the claim, arguing that Jeteck did not prove which part of the payments constituted royalties and which part constituted business income. Consequently, the tax authorities considered the whole amount of the payments as business profits subject to tax only in Israel under the ITT (since Jeteck did not have a permanent establishment in Japan). The payments that Jeteck received were therefore taxed twice, once in Japan and again in Israel. Jeteck contested the assessment of the Israel tax authority and requested it initiate MAP negotiations. The Israel tax authority denied the request claiming that MAP could be initiated only after the Israeli Court had determined the character of the payments. The District Court held in favor of Jeteck and obliged the tax authority to *consider the merits* of the taxpayer's request for MAP assistance, and whether it was justified, before hearing the appeal that Jeteck had filed to the Israeli Court.⁶⁷

This case constitutes a good example for the question at stake. A careful reading of the court's reasoning makes clear that the court did *not* regard the initiation of MAP as an obligation. However, the opinion does espouse the view that the taxpayer has the right to demand that the competent authority to properly use its discretionary powers when deciding whether or not to set a MAP in motion. Nevertheless, the Court acknowledges that when the tax authority deals with an international matter, it will sometimes be required to appraise, in view of the contracting state's practices, the MAP's chance of being successful, the involved expenditures and how the procedure could influence the relations between the two authorities involved.⁶⁸ In

65. Executive Instruction Income Tax No. 23/2001 dated Dec. 16, 2001.

66. See Income Tax Appeal 1255/02 Jeteck Technologies Ltd. v. Assessing Officer Kfar Saba (Tel-Aviv District Court, Apr. 7, 2005).

67. *Id.*, at 11.

68. *Id.*, at 8.

Jeteck, the Israeli competent authority did not revoke the necessity of commencing the MAP, it only took the position that the MAP should be postponed to a later stage. The court disagreed with this position. The court emphasized that it is granting an order to *consider the merits* of the taxpayers' request and not an order to initiate MAP. The court further clarified that the order is granted because the Israeli Competent Authority did not contest the need to commence the negotiations and sought only to postpone them to a later stage.⁶⁹

6. *The Japanese View*

The National Tax Authorities of Japan have also published guidelines for the MAP known as "Commissioner's Directive on Mutual Agreement Procedures."⁷⁰ Section 13 (1) of the Directive provides:

Where the Office of Mutual Agreement Procedures has received an Application for Mutual Consultations and attachments as described in 6(2) and the request is considered to have merit for mutual consultations, the Office of Mutual Agreement Procedures shall, except in the cases given below, propose to commence mutual consultations to the competent authority of the treaty partner nation.

The situation in Japan is similar and the competent authority must determine that the application has merit for consultations in order to agree to initiate the negotiations.⁷¹ This has also been Japan's historical view, as

69. *Id.*, at 11. This decision was cited again, in a later decision rendered by the same Tel-Aviv District Court: Income Tax Appeal 1192/04 Kloteen Yigaal & Sara v. Assessing Officer Kfar Saba (Tel-Aviv District Court, opinion rendered on May 17, 2006). In this case, the Court upheld the tax authority's position not to initiate MAP, which was based on the fact that the taxpayer did not cooperate. The court rules that it will seldom interfere with the authority's decision, especially in a case such as this one, where the competent authority notified the taxpayer that lacking some information and documentation it had requested, it was unable to take a fundamental position as to whether or not to initiate MAP and therefore denied the request.

70. "The Commissioner's Directive on Mutual Agreement Procedures" is available at http://www.nta.go.jp/foreign_language/00.pdf.

71. According to § 13(2) of the Directive, The Office of Mutual Agreement Procedures shall notify the applicant when it does not propose mutual consultations to the competent authority of the treaty partner nation. This also indicates that such authority to deny competent authority assistance exists.

expressed by the National Reporter of Japan in the International Fiscal Association Congress.⁷²

7. *The Australian View*

The Australian tax authorities also condition the initiation of MAP upon a finding that taxpayer's request is justifiable. The taxpayer does not have a right to cause the MAP to be set in motion and in certain circumstances the competent authority will characterize a case as unsuitable for MAP. This was the position of the Australian National Reporter at the International Fiscal Congress.⁷³ This is also the official position in Taxation Ruling 2006/12, which was issued by the Australian Taxation Office and remains valid to date.⁷⁴

8. *The Spanish View*

The Competent Authority of Spain is the General Directorate of Taxes.⁷⁵ As is the case in other countries, the competent authority receives a request for MAP assistance from the taxpayer and determines whether it is justified and whether or not to approach the other competent authority.⁷⁶

Nonetheless, the tax administration is never compelled to start the mutual agreement procedure. Therefore, it may at its election *refuse* to ask the foreign administration to reach an agreement following the procedure and is no longer compelled to find a solution with respect to the double taxation matter, since it only has an obligation to use all the necessary means at its disposal to achieve a good result, and not an obligation to achieve a good result. *The taxpayer has no means to force the competent authority to start the mutual agreement procedure...* However, [T]he taxpayer is

72. See Koch, *supra* note 8, at 327

73. See Koch, *supra* note 8, at 190-191. (enumerating the circumstances under which the competent authority will usually refuse to initiate the MAP negotiations.)

74. Taxation Ruling 2000/16 is available at <http://law.ato.gov.au>. Section 4.4 states that stage one of the consideration process is divided into three elements, the second of which is "consideration by the competent authority whether the case presented is justified."

75. See Fernando Serrano Antón, *Settlements of Disputes in Spanish Tax Treaty Law*, in *Settlement of Disputes in Tax Treaty Law*, *supra* note 14 at 427.

76. *Id.*

allowed to challenge this refusal before courts or administrative bodies since there is a deed to challenge.⁷⁷

This position was upheld by the high courts of Spain. The Spanish Tax Courts' approach was examined by Jose Calderón.⁷⁸ He addresses two different rulings, from the Supreme Court of Spain and another high court (Audiencia Nacional), that he believes to have opened the door to the judicial review of Spanish Competent Authority decisions.⁷⁹ In Calderón's view, these rulings are positive because they acknowledge that the competent authority's administrative decision is subject to judicial review, something that was not that clear before these rulings. Nevertheless, Calderón acknowledges that the Spanish courts should take into account not only the taxpayers' legitimate interests "but also the 'tax policy' reasons underlying in the decision of the Competent Authority denying the setting in motion of the mutual agreement procedure...."⁸⁰

In the above mentioned rulings, both the Spanish Supreme Court and the Audiencia Nacional upheld the competent authority's decision not to initiate MAP. The Audiencia Nacional ruled that the tax conflict was an internal issue that does not concern either the interpretation or the application of the ITT. The Supreme Court found that the tax conflict between the taxpayers and the tax Administration did not have international relevance; that is, the controversy did not involve either the interpretation or the application of the provisions of the Spain-Austria ITT.⁸¹

77. *Id.* at 431-32 (emphasis added.)

78. See Jose M. Calderón, *The Taxpayer's Right to Set the 'Mutual Agreement Procedure' in Motion: the Spanish Tax Court's Approach*, 29 *Intertax* 362 (2001).

79. *Id.*, at 364:

It can be said that as a consequence of these rulings taxpayers' rights deriving from the tax treaties are strengthened; any taxpayer who considers that the actions of the Spanish tax Administration constitute taxation which is not in accordance with a tax treaty can file an application to set in motion the mutual agreement procedure. The Spanish Competent Authority cannot deny such claim without having a legitimate reason; the fact that the decision of the Competent Authority can be subjected to judicial review can exert an important influence in order to limit the discretion of the Competent Authority when deciding whether or not a 'legitimate reason' is met.

80. *Id.*, at 364 (citation omitted).

81. *Id.*, at 363-64. The tax conflicts involved in each of the cases concerned the taxation applicable to a typical interest stripping transaction in which the taxpayers bought . . . [Austrian bonds] and sold them just after collecting the interest derived from the securities; according to the Spain-Austria tax Treaty the interest

These examples clarify that a taxpayer does not have a right to cause the initiation of competent authority negotiations, and that in certain cases the request for MAP assistance will be denied.

9. *The French View*

In summarizing the French tax authority's position on this issue, which follows the above mentioned trend, Hugues Perdriel-Vaissière states,

The practice is to invoke the competent authority procedure where all the required conditions are met. Nonetheless, the tax administration remains *entirely free to refuse* to ask the foreign administration to reach an agreement following the procedure.... Aside from this example (referring to the ITT with Italy which imposes an obligation to settle) the taxpayer has no means of forcing the competent authority to start a MAP.⁸²

10. *The Belgian View*

In Belgium, the taxpayer's "right" to demand the initiation of MAP seems to be better secured. The fiscal administration has no discretionary power to veto MAP. The taxpayer's right is safeguarded since the request for MAP assistance is presented to the regional director of taxes against whose decision the taxpayer can appeal before the courts in accordance with domestic law.⁸³

was exempt from tax in both countries; the taxpayers also considered that the capital loss which resulted from the sales of the Austrian bonds had to be taken into account in computing their taxable income; however, the tax Administration denied the capital loss, considering it a sham.

82. Hugues Perdriel-Vaissière, Settlement of Disputes in French Tax Treaty Law, in Settlement of Disputes in Tax Treaty Law, supra note 14, at 193, 200-01. (emphasis added). Perdriel-Vaissière goes on to note that the Council of State (Conseil d'Etat) and the administrative courts of appeal have always had this point of view and the sources thereof.

83. See Koch, supra note 8, at 223. See also Klaus Vogel supra note 60, at 1367: ("Belgian law, moreover, affords the taxpayer a *legal claim* to have a mutual agreement procedure set in motion.") (emphasis in original, citation omitted). See also Luc Meeus, Settlements of Disputes in Belgian Tax Treaty Law, in Settlement of Disputes in Tax Treaty Law, supra note 14, at 87: ("If it appears to the competent authority of the State where the complaint was filed that the taxation complained if is due, wholly or in part, to a measure taken in the other State, it will be incumbent on it to set in motion the mutual agreement procedure proper.") Belgium's position is

E. *Summary of the Possibilities and Preferred Interpretation:*

It is beyond the scope of this paper to examine every state (Editor: no need to capitalize, correct?) and its internal procedural rulings or customary laws regarding the duty to initiate MAP.⁸⁴ The general trend, however, seems clear: the decision whether or not to initiate MAP is for the competent authority to make.

F. *Justifications: MAP Functions Positively*

As clarified above, MAP is voluntary. When taking this into consideration, in addition to the informality accompanied with the negotiations, the fact that it is a government-to-government negotiation process, its secrecy and the fact that it is not binding on the taxpayer, all these strengthen the view that MAP should be commenced when competent authorities believe it is justified. The spirit of MAP is that it is fully consensual and voluntary and in my mind, imposing a duty to negotiate contradicts with this spirit⁸⁵

based, apparently, on its more general principle of giving higher priority to a (tax) treaty than domestic (tax) legislation. This principle is based on the Belgian Supreme Court decision from 1971 (Cour de Cassation/Hof van Cassatie), 27 May 1971, *Pas.*, 1971, I, 886 (Case of *Fromagerie Franco-Suisse “Le Ski”*), securing individual rights granted under treaties and ensuring that these rights are superior to domestic laws.

84. Note that Denmark, the Netherlands and Finland maintain a similar position. See generally in Michael Lang and Mario Züger, *supra* note 14, the following: Karin Skov Nilaysen, *Settlement of Disputes in Danish Tax Treaty Law*, at p. 143 arguing that it is not possible to force the competent authority of Denmark to initiate MAPs, yet if it decides to refuse a request, it will have to give reasons for the refusal. Eric Velthuisen, *Settlement of Disputes in Dutch Tax Treaty Law*, at p. 158 arguing that: “The specific case mutual agreement procedure provisions do not grant many rights to the taxpayer. It is clear that a taxpayer has the right to present his case to the authorities. But, it is not clear whether the taxpayer can go to a Dutch court and request that a mutual agreement procedure is initiated. The most likely view is that in the Netherlands, the taxpayer is not entitled to call for proceedings; the initiation of the mutual agreement procedure is at the discretion of the authorities.” Marjaana Helminen, *Settlement of Disputes in Finnish Tax Treaty Law*, at p. 188 clarifying that the taxpayer may not force the authority to invoke the mutual agreement procedure or to grant a tax exemption. Entering into negotiations and granting an exemption is totally up to the case-by-case consideration of the authorities. An appeal is not possible against the decision.

85. See Rooney & Suit *supra* note 42 at p.700 noting:

Courts, however, may be especially hesitant to interfere in competent authority negotiations because of the perceived executive nature of the government-to-government negotiation

Interestingly, and despite the near consensus that there is no duty to grant MAP assistance, MAP has generally been successful. This is because states favor MAP, where they do not relinquish their taxing powers, over mandatory and binding arbitration. This is why competent authorities are generally receptive to taxpayers' requests to grant MAP assistance.⁸⁶ In the U.S. refusal to grant MAP assistance is also rare.⁸⁷

During a joint conference of the Canadian and U.S. branches of the International Fiscal Association in Toronto on May 18, 2007 discussing a fifth protocol to the Canada-U.S. income tax treaty, Frank Ng said that: "In general the success rate of competent authority cases handled by the IRS is good, with only about 5% of cases failing to produce tax relief. That tends to suggest the process is working in terms of results."⁸⁸

process and perhaps out of deference to the Service's administration of the tax treaties. Judicial review may also be more difficult when only one party to the negotiation is subject to U.S. jurisdiction, but should not be impossible for that reason alone. It is a more serious objection that foreign governments may decline to negotiate if their positions and approaches would become public in U.S. court proceedings. It may be, therefore, that aspects of the U.S. competent authority process leading up to sovereign-to-sovereign negotiations are the more promising candidates for invoking the courts.

(citation omitted)

86. Cf. James R. Mogle, *Competent Authority Procedure*, 23 *Geo. Wash. J. Int'l L. & Econ.* 725 (1990) (arguing that while treaties generally do not require competent authority assistance requests to be granted, they are typically granted absent unusual circumstances); Perdriel-Vaissière *supra* note 82 (indicating that in France the practice is to invoke MAP); Nilausen, *supra* note 84, at 144 (claiming that the competent authority of Denmark is quite open to initiating a MAP, and resenting a few cases where, despite the fact that the tax authority was unwilling to give up its own taxing rights, the tax authority tried to convince the other country to give up its right to tax or provide other relief on the base of equity).

87. Cole, Venuti, Gordon & Croker, *supra* note 11, at A-34.

88. Lisa M. Nadal, *U.S. Canadian Officials Discuss Upcoming Protocol, Joint Initiatives*, 2007 *Tax Notes Today* 99-7 (May 21, 2007). See also Kathleen M. Matthews, *W.S. Canadian, and Mexican Competent Authorities Discuss Dispute Resolution*, 97 *Tax Notes Today* 96-4 (May 16, 1997) (interviewing Deborah Nolan, then IRS deputy assistant commissioner (international), who said that "[n]inety-five percent of the competent authority cases in the United States are resolved with either 100% or partial relief. . . .")

The Canadian side reports success of the MAP as well. Over 80% of Canadian MAP cases involve the United States, and more than 50% of U.S. cases involve Canada.⁸⁹ CRA reported that:

Of the 303 MAP cases that were resolved in fiscal year 2008-2009, 83 cases were categorized as negotiable, which means that bilateral negotiations with another tax administration were required to resolve an issue. Of the 83 cases negotiated with other tax administrations, 89% of taxpayers who sought assistance obtained full relief from double taxation and 11% did not obtain relief.⁹⁰

In a 2006 public discussion draft dealing with proposals for improving the resolution of international tax disputes, the OECD characterized the cases where the competent authority were unable to reach an agreement as *rare*.⁹¹ This is compatible with the data cited above.⁹²

89. Greg Noble and Robert Turner, Competent Authority Update, Report of the Proceedings of the Fifty-Seventh Tax Conference, Canadian Tax Foundation, p. 29:13.

90. See Canada Revenue Agency, Mutual Agreement Procedure Program Report (Apr. 1, 2008 – Mar. 31, 2009) at http://www.cra-arc.gc.ca/tx/nrsdnts/cmp/mp_rprt_2008-2009-eng.pdf.

91. See the 2006 OECD report, supra note 16. The proposed commentary in this report stated that: “This paragraph provides that, in the *rare* cases where the competent authorities are unable to reach an agreement under ¶ 2, the unresolved issues will, at the request of the person who presented the case, be solved through an arbitration process” (emphasis added). Note that this characterization has been omitted from the OECD report, the final report adopted by the Committee on Fiscal Affairs on 30 Jan. 2007, Feb. 2007, supra note 15. Nevertheless, it is very reasonable to argue that this omission does not indicate a change in the OECD characterization which occurred within the one year period between Feb. 2006 and Feb. 2007. If in fact rare cases remained unresolved through MAP according to the 2006 report, one could presumably rely on this data as being accurate in 2007 as well, especially when this position is evident in the literature. It could well be that this characterization was omitted from the final report due to comments of Michael McIntyre who argued that if in fact only rare cases remain unresolved then it is worth double checking whether adopting the arbitration provision outweighs the other costs associated with such a step. See McIntyre, supra note 10.

92. Other commentators disagree with the general notion in the literature regarding the rate of success of MAP cases. For a thorough discussion see generally Altman, supra note 14. See also Cole, Venuti, Gordon & Croker, supra note 11 at A-36: “Statistics show that most double taxation cases brought before the U.S. Competent Authority are resolved with full relief from double taxation or through withdrawal of the adjustment. However, there are cases where only partial relief or no relief was obtained.”

G. *Structural Deficiencies of the Proposal*

1. *The Two-Step Approach and the Blocking Method*

The link between MAP and arbitration and the fact that arbitration operates only as an extension to the MAP weaken the proposal. Assume that a taxpayer requests competent authority assistance claiming taxation not in accordance with the treaty. Assume further that the competent authority is not interested (say for policy reasons) that the issue at stake be resolved through mandatory and binding arbitration. The competent authority, therefore, takes the position that the request for MAP assistance is unjustified and declines to initiate MAP. As clarified above, this is possible. In this scenario the mandatory and binding arbitration provision will malfunction. This is because under the current proposal, the arbitration will be triggered only after the competent authorities exhaust the MAP negotiations. Because in this example there was no MAP, the arbitration is not triggered. This mechanism will be referred to hereinafter as the Blocking Method. The competent authority utilized this mechanism to block the mandatory arbitration, hence the name.⁹³

The issue of the obligatory feature of the MAP was addressed in the work of William W. Park and David R. Tillinghast in 2004, sponsored by the International Fiscal Association.⁹⁴ The IFA-sponsored draft treaty avoids the

93. See Gerrit Groen, Arbitration in Bilateral Tax Treaties, 30 Intertax 3, 14 (2002), noting:

“As a consequence, if a contracting state is unwilling to enter into a mutual agreement procedure, the mutual agreement procedures have not been fully exhausted, and the dispute can therefore not be submitted to arbitration. Furthermore, the standard arbitration clause does not give a general consent to submit an unsettled dispute to arbitration before the two-year period has elapsed even if it is evident that within this period the dispute will not be resolved through negotiations.”

94. Park & Tillinghast, *supra* note 8. Park and Tillinghast note:

The tax treaty arbitration has a close connection with the mutual agreement procedure. Arbitration would be initiated only after a mutual agreement procedure. Therefore, binding and mandatory arbitration would actually require also that the initiation of a mutual agreement procedure would be obligatory. For example, the Dutch representative (Mr. Gerrit Groen) has pointed out that mandatory tax treaty arbitration should require that the competent authorities would be obliged to initiate a mutual agreement procedure at the request of the taxpayer. It could be considered whether the mutual agreement procedure should be rewritten to this effect. Alternatively, as the representative from Singapore (Mrs. Christina Ng) has suggested, the arbitration article could

problem by taking, as a trigger mechanism, presentation of the claim to only one of the competent authorities.⁹⁵ The OECD proposal was influenced by this work in many respects but not regarding the triggering event.

Structuring the arbitration as an extension of the MAP Article has been referred to as the two-step-approach.⁹⁶ It is not at all clear to me, however, that this is the preferred method. The major problem, as shown above, is the availability of the Blocking Method. The fact that competent authorities are generally receptive to requests for MAP assistance should not, and cannot, justify the existence of the Blocking Method, let alone the fact that this is likely to change, as I argue below.

The OECD has emphasized in its reports that the proposal's major goal is to increase the effectiveness of the MAP.⁹⁷ A risk exists that the proposal will have an opposite effect. The idea of arbitration, in various forms, has been debated for quite a while, yet the majority of states have not embraced it. It is no secret that states are reluctant to give up their taxing powers. This is especially true in cross-border transactions of multinational corporations where millions of dollars of potential revenue is at stake.

expressly state that arbitration would be initiated also in a situation where the taxpayer was unable to avail itself or was denied the mutual agreement procedure notwithstanding the presentation of its case to the mutual agreement procedure.

Id. at 74.

95. Id. 94. It should be noted that there is no reference here to ¶ 2 of Article 25 dealing with the negotiations themselves as in the OECD proposal. William Park expressed a similar view in a Tax Council Policy Institute symposium in Washington in Feb. 2002, See Kevin A. Bell, *Dunahoo Favors Exploring Arbitration to Resolve Competent Authority Disputes*, 2002 Tax Notes Today 31-10 (Feb. 14, 2002).

96. See Luc Hinnekens, *The Search for an Effective Structure of International Tax Arbitration Within and Without the European Community*, in Michael Lang, *Multilateral Tax Treaties*, Series on International Taxation 18 (1998) 539.

97. See the OECD report supra note 15, ¶ 13 noting:

“These additional techniques (referring to the mandatory arbitration) can make the MAP itself more effective even in cases where resort to the techniques is not necessary. The very existence of these techniques can encourage greater use of the MAP since both governments and taxpayers will know at the outset that the time and effort put into the MAP will be likely to produce a satisfactory result. Further, governments will have an incentive to ensure that the MAP is conducted efficiently in order to avoid the necessity of subsequent supplemental procedures. In addition, the introduction of supplementary dispute resolution techniques will reduce the likelihood of costly, time-consuming and possibly conflicting domestic judicial proceedings.”

So why then would states take a different position now and embrace the arbitration? Is it because of the availability of the Blocking Method that states are less concerned? If tax authorities are still reluctant to adopt mandatory and binding arbitration, the proposal will undoubtedly have a boomerang effect. Denying requests for MAP assistance (as an inherent part of utilizing the Blocking Method) will become more attractive. The direct result is blocking the mandatory and binding arbitration. The indirect result is that fewer cases will be referred to MAP (in order not to subject them to mandatory and binding arbitration, in the event they remain unresolved). Eventually, instead of enhancing the MAP and ensuring a “fully effective MAP process that has the confidence of taxpayers”,⁹⁸ the outcome could well be weakening it.

2. *Mapping the Arbitration*

The proposed structure suffers from an additional structural flaw. The differences in the nature of a MAP and mandatory and binding arbitration are sufficient to make the marriage between the two problematic. The current proposal is to add a new paragraph to the existing MAP Article. By “mapping the arbitration,” if I may use this phrase, the proposal mixes two separate proceedings that have significantly different features. MAP is consensual and voluntary whereas mandatory arbitration is compulsory. MAP is a government-to-government diplomatic procedure while mandatory arbitration is referring a dispute to a third and unrelated party for a binding resolution. States should be allowed to control whether or not to grant competent authority assistance while they should not be granted this privilege in mandatory arbitration.⁹⁹ In a MAP the parties are free to settle on grounds that best suits them. This is the advantage of the MAP. And the fact that the taxpayer is not bound by the agreement supports this feature. In mandatory arbitration, on the other hand, it is presumed that general and internationally accepted principals should guide the arbitration panel in reaching its decision and should be the controlling source of law during the arbitration.¹⁰⁰

International arbitration plays a significant role in producing international trans-border rule of law that will constitute a source of law to be

98. OECD, “Improving the Process for Resolving International Tax Disputes” 2, (July 27, 2004), available at <http://www.oecd.org/dataoecd/44/6/33629447.pdf> suggesting a different view when the dispute involves tax arbitrage.

99. See Part H of this chapter suggesting a different view when the dispute involves tax arbitrage.

100. See generally International Fiscal Association, IFA Resolution of Tax Treaty Conflicts by Arbitration, (1994).

referred to in future disputes.¹⁰¹ Some kind of transparency and publicity is therefore necessary in mandatory arbitration. In MAP, confidentiality is an accepted feature.¹⁰² MAP has limitations and restrictions that emerge from domestic and internal legal systems of the Contracting States. The MAP is different in each jurisdiction while mandatory and binding arbitration requires a more unified feature to ensure its success. More importantly, the parties to the arbitration relinquish control over the proceedings,¹⁰³ unlike the case in the MAP where the parties are constantly in control of how the proceedings develop, when and if to settle or when to abandon the negotiations. In other words, there is an inherent distinction between the two proceedings and by “mapping the arbitration,” we defeat the purpose of the mandatory arbitration. The mechanism under the proposal is neither mandatory nor is it arbitration. It lacks the compulsory feature because of the existence of the Blocking Method and the classification as arbitration is inaccurate because the proposed provision lacks basic features that are present in arbitration.

101. See Thomas E. Carbonneau, *The Law and Practice of Arbitration*, 429 (2d ed. 2007) arguing for this point in the International Commercial Arbitration context.

102. See McIntyre, *supra* note 10 at 636:

“Defenders of secrecy are likely to argue that secrecy is a normal feature of an arbitration procedure. It is certainly true that most domestic arbitration proceedings are secret. The analogy to domestic arbitrations, however, is inappropriate. Domestic arbitrations are typically between private parties, the costs of the arbitration are privately financed, and the issues being resolved are private disputes. In sharp contrast, the OECD is proposing an international body that would be charged with the responsibility of deciding the amount of tax due to sovereign states. That dispute is a public dispute, the costs of resolving it are charged to the public, and the parties to that dispute (the governments) are public bodies accountable to their citizens.”

(citation omitted).

103. See Carbonneau., *supra* note 101, at 1 defining arbitration:

“Arbitration is a private and informal procedure for the adjudication of disputes. It is an extrajudicial process. It functions as an alternative to conventional litigation. It yields binding determinations through less expensive, more efficient, expert and fair proceedings. Although it can engender settlements, arbitration is not intended to operate as a means for achieving dispute resolution directly through party agreement. Arbitration is neither negotiation nor mediation. The parties confer upon the arbitrator’s full legal authority.”

A final remark on this issue is noteworthy. Paragraph 46 of the OECD Commentary on Article 25, addressing a situation where MAP was unsuccessful, originally stated:¹⁰⁴

It is difficult to avoid this situation without going *outside the framework of the mutual agreement*.

This approach was not adopted, however, in the current proposal. In the revised commentary, paragraph 46 is replaced with a new paragraph 46 stating that:

The arbitration process provided for by the paragraph is not an alternative or additional recourse....The paragraph is, therefore, an extension of the mutual agreement procedure....¹⁰⁵

The language of the pre-revised commentary seems to suggest a similar logic that MAP and arbitration are two separate frameworks and the mixture of the two is bound to result in confusion and complexity in developing the arbitration and this could undermine the mandatory and binding arbitration.

I think the following comparison could serve as a good example to further illustrate this argument. Assume that a taxpayer files a tax return with the tax authority who in turn disagrees with certain issues, for example allocation of deductions or income. The taxpayer has the option of litigation but, in most cases, it also has available an “internal” appeals process, where the taxpayer attempts to settle the issue with the tax authority before turning to judicial remedies.¹⁰⁶

This internal appeals process enjoys characteristics similar to the MAP: it is voluntary, the parties can decide whether to utilize it or to skip directly to litigation; it is a bilateral negotiation process between the two parties and binding only on the taxpayer and the tax authority, and it has no precedential value. The negotiations are secret, as is any settlement reached. The parties do not relinquish control over the process, the outcome or the determination whether or not to settle. This is the case in MAP as well.

104. See OECD Commentary on Article 25, *supra* note 27, at ¶ 46. (emphasis added.)

105. See OECD report, *supra* note 15, at ¶ 46. (citation omitted).

106. In the U.S. the tax decision reached by the examiner may be appealed to a local appeals office, which is separate and independent of the IRS Office that conducted the examination. If the parties agree, a closing agreement will be signed and the resolution is final. See Internal Revenue Service, Appeals Process, at: <http://www.irs.gov/govt/fslg/article/0,,id=158488,00.html>. See also IRC § 7121.

Nevertheless, if the taxpayer is unable to settle the case with the tax authority through the appeals process (or if it decides not to utilize this option), the case will proceed to litigation, at which point the parties are no longer decision makers. This is now an external proceeding rather than an internal one. The mandatory arbitration resembles the external proceeding while MAP resembles the internal one. These are two separate proceedings.

H. *Arbitrage and Arbitration in Taxation*

International tax arbitrage has been defined as a lofty term that refers to taking advantage of differences among country tax systems, usually differences in addressing a common tax question.¹⁰⁷ I will approach the discussion in this part of the Article in the following manner: first, I will briefly raise the question whether international tax arbitrage is a concern; then, concluding that such a concern exists and under the assumption that oppressing tax avoidance is a goal of the ITT network, I will check how the mandatory arbitration provision addresses this issue and how it fits this framework.

1. *Is Tax Arbitrage a Concern?*

Some commentators argue that the arbitrage is not (and should not) be a concern and so long as a transaction does not rise to the level of a tax shelter or tax evasion, taxpayers should be allowed to benefit from the tax results as permitted by each tax jurisdiction's laws.¹⁰⁸ Nevertheless, other players in the international tax arena side with the opposing view including The League of Nations and the OECD.¹⁰⁹ The U.S. has embraced this view as well.¹¹⁰

107. See H. David Rosenbloom, The David R. Tillinghast Lecture: International Tax Arbitrage and the International Tax System, 53 *Tax L. Rev.* 137, 142. See also Daniel N. Shaviro, More Revenues, Less Distortion? Responding to Cross-Border Tax Arbitrage, 1 *N.Y.U. J. L. & Bus.* 113, 116: "taking advantage of inconsistencies between different countries' tax rules to achieve a more favorable result than that which would have resulted from investing in a single jurisdiction."

108. See Rosenbloom, *supra* note 107.

109. See generally *supra* notes 11-13.

110. See IRS News Release LS-1068 (Dec. 8, 2000) "Challenges for Tax Policy in a Global Economy," Treasury Acting Assistant Secretary for Tax Policy Jonathan Talisman Remarks to the IRS/GW Annual Institute on Current Issues in International Taxation, Washington, DC, available at <http://www.ustreas.gov/press/releases/ls1068.htm> (arguing that tax arbitrage is problematic and distorts economic behavior).

2. *The Relevance to the Mandatory Arbitration Provision*

One might wonder what relevance the above issue has to the discussion of mandatory and binding arbitration. Michael McIntyre has pointed out this relevance.¹¹¹ McIntyre argues that mandatory and binding arbitration could facilitate double non-taxation because taxpayers can utilize the arbitration to achieve no-tax results. The assumption behind this argument is that the arbitration panel will resolve the disputes based, first and foremost, on the wording of the ITTs.¹¹² Therefore, in the same manner that taxpayers utilize the ITTs to achieve double non-taxation they will be able to utilize the mandatory and binding arbitration to enforce double non-taxation.

Surprisingly (or not) the OECD did not address this issue. The proposal addresses only double taxation cases. The OECD did not condition triggering the mandatory arbitration upon actual double taxation. This is the case in the EU convention for the arbitration of transfer pricing disputes.¹¹³ Had this approach been adopted, this would have eased the concern of tax arbitrage.

111. See McIntyre, *supra* note 10.

112. See Sample Mutual Agreement on Arbitration (“Applicable Legal Principles,”) attached annex to the OECD report, § 14, *supra* note 15:

The arbitrators shall decide the issues submitted to arbitration in accordance with the applicable provisions of the treaty and, subject to these provisions, of those of the domestic laws of the Contracting States. Issues of treaty interpretation will be decided by the arbitrators in light of the principles of interpretation incorporated in Articles 31 to 34 of the Vienna Convention on the Law of Treaties, having regard to the Commentaries of the OECD Model Tax Convention as periodically amended, as explained in ¶¶ 28 to 36.1 of the Introduction to the OECD Model Tax Convention. Issues related to the application of the arm’s length principle should similarly be decided having regard to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. The arbitrators will also consider any other sources which the competent authorities may expressly identify in the Terms of Reference.

113. See Convention on the Elimination of Double Taxation in Connection with the Adjustments of Profits of Associated Enterprises, Article 14 (addressing the scope of the convention and clarifying that its application is in double taxation cases), available at www.vilp.de/Enpdf/e271.pdf. See also *Id.* at Article 6 and 7 making clear that the MAP and arbitration procedures are triggered where double taxation has not been removed.

I will borrow an example from Lee Burns¹¹⁴ to illustrate this issue. Burns addresses an arbitrage known as the “double dipping” transaction, where the transactions are structured in a way that a single expenditure is deducted twice. The key to the tax benefit under such transactions is that the expenditure is deducted against two separate amounts of income in two countries with neither country taxing both amounts.¹¹⁵ The example presented by Burns is that of a cross-border finance lease that involves the lessor (financier) in one country and the lessee in another country. The aim of a cross-border leasing transaction is to structure the transaction so that the tax treatment of the lease is different in the two countries - it is treated as a lease for tax purposes in the financier’s country of residence and as a purchase on credit in the lessee’s country of residence. This means that both the financier and the lessee can claim deductions in relation to the ownership of the asset (particularly, depreciation deductions). These deductions are applied against the income of the lessor (financier) and against the income of the lessee. While both countries are allowing a deduction for the same costs, each country is taxing only one amount of income. So a single outlay is being deducted against two separate amounts of income by two different taxpayers in two different countries.¹¹⁶ If one of the countries disallows the deduction under tax avoidance principles and the dispute is eventually referred to an arbitration panel for resolution, it appears that the arbitration panel would have no other option but to accept and enforce the structure of the transaction resulting in double non-taxation.¹¹⁷

114. Lee Burns, Cross-Border Tax Arbitrage, 2001 Tax Conference, ADB Institute (Sep. 5-11, 2001), available at: http://www.adb.org/Documents/Events/2001/Tax_Conference/tax_arbitrage.pdf.

115. *Id.* at 2.

116. *Id.* at 6.

117. For further illustration see McIntyre, *supra* note 10 at 627:

Double non-taxation cases are themselves common and are often the goal of sophisticated tax planning. As an example, assume that Country A exempts capital gains and Country B does not. Country B, however, has a tax treaty with Country A that exempts some but not all capital gains earned in Country B by a resident of Country A. The taxpayer, a resident of Country A, earns a capital gain of \$100 million in Country B, which it claims is exempt from tax in Country B under the tax treaty. The tax officials of Country B disagree and have a reasonable basis for that disagreement. The taxpayer asks the competent authorities of Country A to intervene on its behalf, claiming that taxation by Country B is ‘not in accordance with’ the treaty. If the matter were to go to arbitration and the taxpayer were to win, the result would be international double non- taxation.

The OECD proposal does not contribute to achieving the two primary goals of the ITT network. In fact, it can be utilized to defeat them. The result is that a negative answer will be given to the two evaluation questions presented in part one of the Article thereby facilitating the conclusion that the proposal, in its current structure, should be reexamined.

III. THE UNITED STATES AND MANDATORY AND BINDING ARBITRATION

A. Introduction

The situation in the U.S. regarding mandatory and binding arbitration of international tax disputes does not differ from that in other countries. The U.S. has agreed to include, in some ITTs, ad hoc arbitration provisions, where the Contracting States can refer a dispute to arbitration if and when both countries agree to do so. This is usually referred to as “voluntary” arbitration.¹¹⁸ In this case, the Contracting States are under no obligation to refer the dispute to arbitration and the authority to do so is entirely committed to their discretion. For Example, this is the situation in the ITT between the U.S. and Mexico and the previous ITT between the U.S. and Germany before the recent change, as will be addressed below.¹¹⁹

However, despite its existence in some ITTs, voluntary arbitration has not been utilized. I have personally contacted the Competent Authorities of both Germany and Mexico inquiring how many disputes between each of these countries and the U.S. have been referred to arbitration under the voluntary arbitration provisions. Both respectful representatives replied that not any disputes have been referred to voluntary arbitration.

When the then new voluntary arbitration provision in the German-U.S. ITT was first introduced, it was regarded a major and even unusual step because this was the first time an arbitration provision was presented.¹²⁰ This was the notion despite it being voluntary arbitration.¹²¹ Nonetheless, as mentioned, this provision was never tested. It was broadly worded granting both Contracting States discretion as to how, when and if to submit a dispute to arbitration.

The question I wish to address in this part of the Article is whether or not there has been a change in the U.S. tax treaty policy regarding the inclusion of mandatory and binding arbitration provisions in its ITT network.

118. For an exhaustive discussion regarding the distinction between pre-dispute and post-dispute provisions see Park & Tillinghast, *supra* note 8.

119. See *infra* note 137.

120. See Andre P. Fogarasi, et al., Use of International Arbitration to Resolve Double Taxation Cases, 18 Tax Mgmt. Int'l J. 319 (Aug. 11, 1989).

121. *Id.* at 320, citing Joseph H. Guttentag and Ann E. Misback, Resolving Tax Treaty Issues: A Novel Solution, Bull. For Int'l Fiscal Documentation (1986).

Do the recent ratifications of the protocols to the ITTs with Germany, Belgium, Canada and France, in which mandatory and binding arbitration provisions have been introduced, indicate a policy change? And if yes, to what extent is the U.S. willing to implement this policy, what method of arbitration will be favored, is the referral to arbitration in fact guaranteed and how will the proposed provisions operate?

B. Historical Background

It is not a secret that the United States, as other countries, has opposed the inclusion of mandatory arbitration in its ITT network. This was the position of the National Reporters of the United States presented in the 1981 conference of the International Fiscal Association.¹²²

The previous voluntary arbitration provision in the ITT with Germany was advanced by the German government and therefore some scholars have doubted this indicated a policy decision from a U.S. perspective.¹²³ During the discussions for the inclusion of a voluntary arbitration provision in the Canada-U.S. ITT, it was clarified in the

122. See Koch, *supra* note 8, at 279:

It is understood that the IRS does not favor arbitration, as it believes that the Mutual Agreement Article will work better if it continues to represent the US. Since there are many factors involved in the resolution of Mutual Agreement cases, arbitration would prevent the consideration of all these factors and the development of the bilateral rapport that has been so important in the resolution of cases until now.

See also OECD, *Transfer Pricing and Multinational Enterprises: Three Taxation Issues*, *supra* note 8, for the OECD Position at that time. See also Forgarasi, *supra* note 120, at 321: “We understand that the IRS and Treasury representatives to the OECD were reluctant to accept the principles of arbitration to resolve double taxation cases, feeling that such a procedure would, in effect, be ceding the U.S. government’s right to determine and assess its taxes.”

123. See Mark K. Beams, *Obtaining Relief Through Competent Authority Procedures and Treaty Exchange of Tax Information – The US Approach*, 46 *Bull. For Int’l Fiscal Documentation*, 119 (1992) at 121, addressing the then recently ratified treaty with Germany with the earlier version of the voluntary arbitration provision,

Because the German government advanced this concept, it is not clear the extent to which it represents the current treaty policy of the United States, and it is therefore unclear whether this provision will appear in future U.S. treaties; indeed some more recent treaties have appeared that contain no arbitration provision.

For a different opinion, see Forgarasi, *supra* note 119 at 321: “The acceptance of the arbitration provision in the proposed U.S.-German income tax treaty indicates a change in view, at least by the Treasury Department negotiators.”

explanation of the proposed protocol to the ITT, prepared by the Joint Committee on Taxation, that the application of this provision was limited.¹²⁴

This approach was the United States' position with other treaty partners where voluntary arbitration provisions were adopted.¹²⁵

Hesitancy toward mandatory arbitration continued to persist. In an annual meeting of the Federal Bar Association Tax Section in March 1996, devoted to the competent authority process, IRS assistant commissioner for international tax matters, Mr. John Lyons, noted that arbitration procedures are interesting concepts, but he cautioned against putting too much hope in the arbitration process. He concluded, based on U.S. experience, that even agreeing to the architecture for arbitration takes an exceedingly long and difficult period of time.¹²⁶ This was also the notion at the ABA Tax Section meeting that took place on May 10, 1997.¹²⁷ The U.S. maintained this

124. See Staff of Joint Comm. on Taxation, Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Canada 44 (Joint Comm. Print (1995), available at: http://www.house.gov/jct/pubs_byyear_1995.html):

Even within the bounds of the competent authorities' decision making power, there likely would be issues that one or the other competent authority would not agree to put in the hands of arbitrators. Consistent with these principles, the Technical Explanation expects that the arbitration procedures will ensure that the competent authorities generally would not accede to arbitration with respect to matters concerning the tax policy or domestic tax law of either treaty country.

125. See Robert Green, *Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes*, 23 *Yale J. Int'l L.* 79, 101 (1998) and references thereafter. He states that:

Arbitration under these U.S. treaties will be voluntary, occurring only when both governments and the affected taxpayer agree to submit the case and to be bound by the award. The United States, Germany, Mexico, and the Netherlands have further stipulated that they generally will not agree to arbitrate matters concerning "tax policy or "domestic tax law."

The U.S. legislative history of the treaties with Canada, France, and Kazakhstan also suggests that arbitration under these tax treaties likely will be confined to fact-specific disputes.

126. See Susan Lyons, *Competent Authority Process Discussed at FBA Meeting*, *Tax Notes Today* (Mar. 11, 1996), available at LEXIS (96 TNT 49-5).

127. See Kathleen Matthews, U.S., Canadian, and Mexican Competent Authorities Discuss Dispute Resolution, *Tax Notes Today* (May 19, 1997), available at LEXIS (97 TNT 96-4): "The competent authorities of Canada, Mexico, and the United States said May 10 that they do not see increasing the availability of arbitration as an important incentive to resolve disagreements." Representing the U.S. was IRS deputy assistant commissioner (international) Deborah Nolan, who made clear that the United States does not intend or desire to invoke arbitration as long as the competent authority process continues to enjoy its 90% success rate. She

consistency in its position during the Uruguay Round of negotiations over expanding the General Agreement on Tariffs and Trade (“GATT”). Against the position of all the other members, the U.S. maintained its resistance to the national treatment obligation of the GATT to apply to income tax measures until very limited language was adopted.¹²⁸

C. *Has the U.S. Tax Treaty Policy Changed?*

In the last 10 years or so, it seems as if the positions of IRS officials have deviated from consistent reluctance to “willing to consider” mandatory and binding arbitration. This, at least, is the impression from some of the interviews with IRS officials throughout this period.¹²⁹ In his testimony before the Senate Committee on Foreign Relations on Pending Income Tax Agreements, John Harrington, Treasury International Tax Counsel stated:

Over the past few years, we have carefully considered and studied mandatory arbitration procedures. In particular, we examined the experience of countries that adopted mandatory binding arbitration provisions with respect to tax matters. Many of them report that the prospect of impending mandatory arbitration creates a significant incentive to compromise before commencement of the process. Based on our review of the U.S. experience with arbitration in other areas of the law, the success of other countries with arbitration in the tax area, and the overwhelming support of the business community, we concluded that mandatory binding arbitration as the final step in the competent

denied any knowledge of the United States engaging in discussions on its possible inclusion in the EC arbitration directive. See also Jacqueline Manasterli, *Multinational Government Officials Address Secret Comparables at IRS- GW International Tax Institute, Worldwide Tax Daily* (Dec. 11, 1998), available at LEXIS (98 TNI 238-1).

128. For an exhaustive discussion regarding the development of the negotiations and the U.S. position see Green, *supra* note 125.

129. See Tax Notes International’s interview with Carol Danahoo, former U.S. IRS Competent Authority, (Jan. 19, 2004), available at LEXIS (2004 WTD 12-5). Danahoo argues for the inclusion of mandatory and binding arbitration to the U.S. treaty policy and believes that such a provision is in need. She argues for mandatory and binding “Baseball” arbitration where the taxpayer is heard and the outcome of the arbitration is not published. See also Kevin Bell, *Germany-U.S. Tax Treaty Arbitration Process Addresses Sovereignty Issue*, 43 *Tax Notes Int’l* 214 (July 17, 2006).

authority process can be an effective and appropriate tool to facilitate mutual agreement under U.S. tax treaties.¹³⁰

He also mentioned that: “Moreover, a country’s fundamental tax policy choices are reflected not only in its tax legislation but also in its tax treaty positions.”¹³¹

Nevertheless, I believe it would be dubious to claim that the United States’ tax treaty policy has changed. First of all, why wasn’t such a provision included in the revised U.S. MC released November 2006? One explanation offered by Benedetta Kissel, Treasury Deputy International Tax Counsel was: “We don’t want to get ahead of Senate.”¹³² I am skeptical as to how convincing this argument is and to me it still seems that the U.S. is hesitant when it comes to adopting mandatory and binding arbitration.

Second, when comparing the scope of the MAP Article in the U.S. MC and the proposed arbitration provisions, an attempt to narrow the application of mandatory and binding arbitration is evident. The MAP Article is broad in coverage and is intended to apply to a wide variety of disputes. The U.S. has taken steps towards expanding the application and utilization of MAP.¹³³ The MAP Article in the U.S. MC is even broader in its language than that of the OECD MC. For example, a taxpayer can present its case to any of the competent authorities and is not limited to the resident competent authority, as is the case in the OECD MC. The structure of the arbitration provisions in the U.S. follows the two-step-approach as well.¹³⁴ Not all disputes eligible for discussion and resolution under MAP, however, fall within the scope of the mandatory and binding arbitration. The ITTs between the U.S. and Belgium, Germany, Canada and France grant the competent authorities discretion to agree that certain cases are not suitable for arbitration.¹³⁵ In the ITTs between the U.S. and both Germany and

130. See John Harrington, Treasury International Tax Counsel Recommends Committee Approval of Four Pending Income Tax Agreements, Tax Notes Today (Jul. 18, 2007), available at LEXIS (2007 TNT 138-60).

131. Id.

132. See Robert Goulder, U.S. Tax Officials Talk up Treaty Arbitration, *Worldwide Tax Daily* (Dec. 15, 2006), available at LEXIS (2006 WTD 241-1).

133. See generally Christine Halphen and Ronald Bordeaux, International Issue Resolution Through the Competent Authority Process, 9 *Tax Notes Int’l* 433 (Aug. 8, 1994). See also *supra* note 14 and accompanying text. The fact that very few requests for MAP assistance have been denied can indicate the trend to utilize this mechanism at maximum.

134. Note that here the provision refers the *case* to arbitration unlike the OECD proposal that refers only the unresolved issues to the arbitration.

135. See for example the Convention between the Government of the United States of America and the Government of the Kingdom of Belgium for the

Canada, yet additional limitations were added. In the ITT with Germany, disputes regarding the Dividends and Interest Articles were excluded from the scope of the mandatory and binding arbitration.¹³⁶ In the ITT with Canada, in addition to the Dividend and Interest Articles, certain disputes under the Royalties Article were also carved out of the scope of mandatory and binding arbitration.¹³⁷

Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, (Nov. 27, 2006), available at LEXIS (2006 WTD 229-7).

136. See Protocol Amending the Convention between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to certain other Taxes, (Jun. 1, 2006), available at LEXIS (2006 WTD 107-9). The protocol amends ¶ 22. The new ¶ 22 states:

In respect of any case where the competent authorities have endeavored but are unable to reach an agreement under Article 25 regarding the application of one or more of the following Articles of the Convention: 4 (Residence) (but only insofar as it relates to the residence of a natural person), 5 (Permanent Establishment), 7 (Business Profits), 9 (Associated Enterprises), 12 (Royalties), binding arbitration shall be used to determine such application, unless the competent authorities agree that the particular case is not suitable for determination by arbitration. In addition, the competent authorities may, on an ad hoc basis, agree that binding arbitration shall be used in respect of any other matter to which Article 25 applies.

137. The full version of the protocol is available at LEXIS (2007 TNT 185-82). In the letters exchanged between the two governments, it is clarified that the mandatory arbitration will deal only with specified issues:

In respect of any case where the competent authorities have endeavored but are unable to reach a complete agreement under Article XXVI (Mutual Agreement Procedure) of the Convention regarding the application of one or more of the following Articles of the Convention: IV (Residence) (but only insofar as it relates to the residence of a natural person), V (Permanent Establishment), VII (Business Profits), IX (Related Persons), and XII (Royalties) (but only (i) insofar as Article XII might apply in transactions involving related persons to whom Article IX might apply, or (ii) to an allocation of amounts between royalties that are taxable under ¶ 2 thereof and royalties that are exempt under ¶ 3 thereof), binding arbitration shall be used to determine such application, unless the competent authorities agree that the particular case is not suitable for determination by arbitration. In addition, the competent authorities may, on an ad hoc basis, agree that binding arbitration shall be used in respect of any other matter to which Article XXVI applies. If an arbitration proceeding (the

Last, a common feature to the U.S. arbitration provisions is the use of the so called “Baseball” arbitration where the arbitral panel can choose only one of the two proposed resolutions submitted by the Contracting States.¹³⁸ Officially referred to as “Final-Offer” arbitration, this is an arbitration in which each party submits a “final offer” to the arbitrator, who may choose only one.¹³⁹ This type of arbitration does not suit disputes regarding the existence of a permanent establishment, for example, or the definition of terms such as “investment bank,” “royalties” or “services.”¹⁴⁰

For the reasons mentioned above, I believe the U.S. expresses a policy position aimed at limiting the application of mandatory and binding arbitration.¹⁴¹

IV. CONCLUSION

A. *Addressing the Concerns*

I have attempted to present the structural deficiencies that exist in the current proposals for mandatory and binding arbitration. Addressing these deficiencies is not the only amendment that could improve the proposals.

“Proceeding”) under paragraph 6 of Article XXVI commences, the following rules and procedures shall apply....

138. The relevant provision in the U.S. – Belgian ITT for example states that: “The arbitration board will deliver a determination in writing to the Contracting States within six months of the appointment of its Chair. The board will adopt as its determination one of the Proposed Resolutions submitted by the Contracting States.” Protocol Belgium/USA 27/11/2006, Convention between the Government of the Kingdom of Belgium and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income; available at www.treas.gov/press/releases/reports/initialed%20protocol%20%2011.20.06%20%20final%20for%20printing.doc.

139. Black’s Law Dictionary 41, (8th ed. 2004).

140. See Park, *supra* note 9, noting that: “However, for other issues the more traditional process might be appropriate.” For example, arbitrators might be asked to determine what is a royalty (as opposed to personal services), interest (as opposed to rent in a finance lease), or to decide where the taxpayer has a “center of vital interest: or a permanent establishment. In international tax arbitration in which taxpayers are given a role it is uncertain how the baseball format would work.”

141. I will note that between the time this article was originally written and its publication, the U.S. Senate ratified a new protocol to the ITT with France which, among other things, added the mandatory arbitration provision discussed above. During the hearing before the Senate Foreign Relations Committee, Manal Corwin, international tax counsel to Treasury, testified that mandatory arbitration would not be included in the U.S. MC and will be considered only on a case-by-case basis. See Kristen A. Parillo, No Plans to Include Mandatory Arbitration in U.S. Model Treaty, Treasury Official Says, *Worldwide Tax Daily* (Nov. 12, 2009), 2009 WTD 216-1.

Scholars have raised additional concerns regarding issues such as the selection of the arbitration panel, implementation of the arbitration decision and conflicts with domestic laws, time limitations, precedential value of the decisions, taxpayer participation in the proceedings, the binding aspect of the decision to the States and to the taxpayer, appointing the arbitrators, review of the arbitration decision, the costs and expenses of the proceeding, legal status of the treaty and commentary and, the language of the arbitration.¹⁴²

I have chosen to focus on the structural problem which in my mind is the first step in the adoption of such proposals. The mechanics of the arbitration are not less important than the structure of the provision itself, yet the structure is the foundation. Adopting a provision which lacks structural consistency with the anticipation of future fixings is similar to building on weak foundations. This is why I believe that no arbitration is better than bad arbitration. If it were up to me, I would adopt mandatory and binding arbitration only when we are certain that it will function positively and not in a situation, as is currently, where reasonable risks of wrongful application (or non-application) are present.

A major flaw is the availability of the Blocking Method which defeats the basic concept of mandatory arbitration. Because of the Blocking Method, the mandatory and binding arbitration will lose its efficiency and effectiveness. The provision will not function in a manner compatible with the goals of the ITT network. On one hand, it does not secure the prevention of double taxation and on the other hand, it could be abusively utilized to achieve a no-tax result.

The concern of the ITTs historically was to prevent double taxation. This concern played a leading role in the evolution of the ITT network. Yet nowadays more attention is given to preventing double non-taxation and confronting sophisticated and aggressive tax planning strategies. This change clouds the necessity for mandatory and binding arbitration. Accepting the status quo and postponing the adoption of mandatory and binding arbitration might not a bad option.¹⁴³ The characterization of the OECD that the

142. See generally Park & Tillinghast, *supra* note 8. See also Park *supra* note 9. See also McIntyre, *supra* note 10. See also Altman *supra* note 14. See also Züger *supra* note 14. See also Desax & Veit, *supra* note 18. See also Morgan *supra* note 18. See also Ault, *Improving the Resolution of International Tax Disputes*, 7 Fla. Tax Rev. 137 (2005) and *infra* note 146. See also Groen, *supra* note 93.

143. See Groen, *supra* note 93, at 27, expressing a skeptical view as to the adoption of mandatory arbitration claiming:

Mandatory arbitration at the request of the taxpayer should not be introduced, due to the obscurity of tax treaties on many issues such as e-commerce and hybrid entities. In cases like these it may be difficult for a board to decide a case on the basis of the treaty and principles of international law, thereby increasing the likelihood of decisions based primarily on considerations of equity which

unrelieved cases of double taxation are “rare”¹⁴⁴ buttresses this conclusion. The overall result does not seem that dramatic. The ITTs have been developing for years and changes in one tax jurisdiction have affected others. The consensus regarding taxpayers’ protection against double taxation is strong and this explains why only a small portion of double taxation cases remain unresolved.

The question is whether it is plausible to anticipate that the same course of development will occur with the campaign against double non-taxation. Is it reasonable to predict that contracting states will acknowledge the necessity of accepting harmonized and uniformed principles such as the single tax and the matching principles? Will countries accept the argument that aligning their tax systems as much as possible will have an overall benefit? Trends in this direction are evolving constantly and the OECD’s focus on this issue is the best evidence.

The ultimate goal should be to arrive to a mandatory and binding arbitration provision uniformed in terms of the triggering event, with taxpayer participation, binding to all parties and with clear guidelines regarding the initiation of the arbitration, how to conduct it and which controlling principles to follow. While I appreciate that this may be too much to ask for, the question remains whether to adopt the current proposals or to reexamine them before doing so. I have advocated against introducing mandatory and binding arbitration as proposed. The current proposals do not meet the basic goals of the ITT network, fail the two evaluation tests set forth in part one of the Article and are neither efficient nor effective. They could be abused both by competent authorities and by taxpayers.¹⁴⁵

B. *A More Effective Structure?*

As an alternative, I believe the mandatory and binding arbitration should be introduced as an independent stand-alone provision. The nature and core of MAP are its consensual and voluntary features. These do not exist in arbitration when it is *mandatory* and *binding*. This resembles the

should be avoided. Only with respect to specific factual disputes, such as transfer pricing disputes, could mandatory arbitration at this point in time be considered. Moreover, further research should be done on the implementation of arbitration awards in the national legal order of the states involved and guidelines should be drafted concerning the annulment of the award by municipal courts in order to avoid incongruent implementation of the award.

144. See supra note 91.

145. In addition, note that the difference in the provisions adopted by the U.S. (with baseball arbitration) and mandatory arbitration under the OECD proposal (which will presumably be followed by the majority of the OECD member States) will cause additional confusion.

dispute resolution mechanisms under Bilateral Investment Treaties and Free Trade Agreements. This is the case in the EU transfer pricing convention as well.¹⁴⁶ The arbitration should be triggered in the case of a dispute, as the default mechanism for the resolution of the dispute, at the request of the taxpayer, unless both competent authorities express their willingness to commence MAP negotiations, in which case the arbitration will be postponed. If the parties are able to settle the case, we can applaud the result. If within the two year period they do not settle, the dispute will be transferred to mandatory and binding arbitration for final resolution. When one or both competent authorities deny a MAP request, the arbitration will be triggered with no need to wait for the two year period to elapse.

In addition, the arbitration should be conditioned on actual double taxation from which the taxpayer is seeking relief. I realize that not only double taxation could be a violation of ITTs.¹⁴⁷ Nevertheless, this condition will mitigate the concern that taxpayers can achieve no-tax results. Taxpayer participation seems necessary, as a party potentially affected by the arbitration decision. This would require the taxpayer to waive its domestic remedies and accept the outcome, as was the situation in the original draft of the OECD. In addition, some sort of transparency would contribute to strengthening and implementing the arbitration.

By making these modifications it will be possible to achieve the following: First, this will eliminate the availability of the Blocking Method. Denying MAP assistance in order to prevent triggering arbitration is not available under this structure. Second, the effectiveness and efficiency of MAP will be enhanced. This structure will motivate the competent authorities to go to length in their efforts to settle. When being subject to mandatory and binding arbitration is a definite alternative, competent

146. See Desax & Veit, *supra* note 18, at 413:

A person familiar with international commercial or investment arbitration may regret that OECD has shied away from setting up an independent system of arbitration. However, it must be recognized that the process leading to the proposal to supplement the mutual agreement procedure by arbitration had been a tedious one whereby lots of obstacles had to be removed. Several national tax authorities were afraid that by setting up an independent system of arbitration, they would give up a substantial part of their legal prerogatives to tax, which could raise delicate constitutional issues.

See also Hugh Ault, *Arbitration in International Tax Matters: Some Structural Issues*, Series of International Taxation No. 27, (Kluwer Law), (2001) at 63: "More useful, perhaps, would be to provide a separate article in the Model Convention which would actually set forth a coherent arbitration scheme."

147. See Mario Züger, *ICC Proposes Arbitration in International Tax Matters*, 2004 *European Taxation* 221, 224.

authorities will find it more “attractive” to negotiate with the perception of settling. We could then expect more cases to be referred to MAP than under the current proposals. This is bound to improve the effectiveness of the MAP and to motivate the competent authorities to efficiently take advantage of it. Third, this structure will presumably goad tax administrations to augment the authority delegated to their competent authorities. The goal would be to enable the competent authorities to freely negotiate with broader authority to settle. Fourth, by conditioning the arbitration on the existence of double taxation we mitigate the concern that taxpayers seeking under-taxation results can rely on the arbitration provision to execute this strategy.¹⁴⁸

The OECD and many commentators have argued that the mere existence of mandatory and binding arbitration will make the MAP more effective.¹⁴⁹ This argument has been presented by proponents of mandatory and binding arbitration in only so many occasions. Yet this is not applicable to the current proposals. By utilizing the Blocking Method the competent authorities can block triggering the mandatory and binding arbitration. The mandatory and binding arbitration is not an incentive to utilize MAP, under

148. At this point the reader may wonder how to reconcile between the voluntary nature of MAP and this alternative that in effect turns MAP into an inevitable alternative. Two comments are offered: first, this is only an alternative. Maintaining the status quo for the time being doesn't carry harsh results and is as good a solution. Second, only double taxation cases are at stake. In this case, if the competent authorities do not want to negotiate, they are free to do so, but taxpayer is provided with full protection from being taxed twice. If they decide not to negotiate and no double taxation is at stake, this is a bearable result as well.

149. See OECD report *supra* note 15. See also Park & Tillinghast, *supra* note 8 at 20:

“Perhaps the most significant effect of treaty arbitration provisions will lie in the incentive to the competent authorities to arrive at prompt and satisfactory agreements. Certainly, the number of cases which would actually go to arbitration would be a small fraction of those which entered the competent authority process.”

See also Desax & Veit, *supra* note 18, at 429: “Possibly, the mere existence of the supplemental arbitration procedure will cause the competent authorities to reach agreement, and to reach agreement before the two-year waiting period to institute arbitration proceedings expires.” See also Yitzhak Hadari, *Resolution of International Transfer-Pricing Disputes*, 46 *Can. Tax J.* 29, 57 (1998):

It is contended that the mere fact that rules of compulsory arbitration are added to tax treaties would strongly encourage the competent authorities of the countries involved to resolve the dispute before the invocation of this avenue of this last resort. Thus, an arbitration mechanism would serve a useful purpose even if it were not invoked in practice.

See also Thomas Rixen, *A Politico-Economic Perspective on International Double Taxation Avoidance*, 49 *Tax Notes Int'l* 599 (2008).

the current proposals, but rather a disincentive. On the other hand, when the mandatory and binding arbitration clause is an independent stand-alone provision, triggered as discussed above, the only way to “block” the arbitration is by settling the dispute. In this latter case, the mandatory and binding arbitration functions as an incentive to utilize MAP.

I recommend reexamining the proposals before their adoption augments.

The Holy Bible, Proverbs (chapter XV, v. 17):

*“Better is a dinner of herbs where love is, than a stalled ox and hatred
therewith”*