has shown that “the more close the ties between the countries, the more alive is the cooperation”. 59 Hopefully, the OECD Member countries are sufficiently connected with each other to ensure the success of the OECD Agreement.

1. THE INSUFFICIENCY OF THE MUTUAL AGREEMENT PROCEDURE

Notwithstanding the wide recognition of the mutual agreement procedure – envisaged in Art. 25(3) of the OECD Model Tax Convention1 (OECD Model) – as an efficient and flexible instrument in the interpretation, application and development of tax treaties,2 this mechanism has been extensively criticized in international tax legal scholarship.

The main inconveniences of the mutual agreement procedure, pointed out both by the commentators3 and the international organizations,4 in particular by the International Fiscal Association5 (IFA), can be summarized as follows:

– the competent authorities have no obligation to reach an agreement but only to communicate with each other and negotiate in order to clarify the interpretative dispute. In other words, even though the purpose of the provision is to reach an agreement, a solution to the conflict is not guaranteed because the states are merely required to exercise their best efforts;5
– there are no time limits within which a solution is required to be found. This results in delays in the procedure, another important deficiency7 of this mechanism.

In fact, the settlement of the case may take several years because of differences in language, procedures and legal and accounting systems, as well the inability of the tax authorities to come to an agreement;8
– concerning the publication of the agreement, the criteria adopted are not homogeneous, which is obviously unsatisfactory; thus it depends on the discretion of each state whether the interpretative mutual agreements are eventually published. Considering that the first sentence of Art. 25(3) of the OECD Model, in contrast to the narrower procedure established in Art. 25(1), grants the power to seek a solution that has precedentual value, i.e. that is not just binding in the specific case, the lack of uniformity in the publication of the agreement represents an even greater disadvantage of the “consultation procedure”;
– the mechanism of the mutual agreement procedure does not oblige revenue authorities to implement the solution (if one is reached). On the contrary, more often than not the implementation of the agreement depends upon the domestic laws of the contracting parties, which leads consequently to divergent results in each state;
– to make matters worse, some countries tend to adopt a neutral attitude towards the mutual agreement procedure, i.e. they do not demonstrate any interest in using this dispute resolution mechanism, maybe because of the aforementioned deficiencies.


INTERNATIONAL

Compulsory Arbitration as a Last Resort in Resolving Tax Treaty Interpretation Problems

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Taking the insufficiencies of the mutual agreement procedure as a starting point, this article attempts to provide a feasible solution in the form of mandatory arbitration that would be triggered once the consultation procedure has failed. This would be achieved by adding an incentive for the competent authorities to resolve the controversial interpretation under the *procédure amiable*.

The fact that the wording of Art. 25(3) of the UN Model and Art. 25(3) of the US Model (which additionally includes an inexhaustive list of factual questions on which the revenue authorities are authorized to consult and reach an agreement on) are identical to each other but differ from the wording of the same provision in the OECD Model emphasizes the difficulty in finding an appropriate solution.

Neither the Nordic Convention of 1996 nor the Andean Group Model Tax Treaty set out an alternative or complementary measure to supersede the impediments of the traditional mutual agreement procedure.

As stated above, this issue has been the subject of extensive discussion in the literature. The conclusion is that the main reason for difficulty resides in the reluctance of the contracting states to transfer their power to decide upon the terms of a settlement to a body beyond their control, because of the diminution of their fiscal sovereignty that this would imply. In this respect the OECD Committee on Fiscal Affairs also noted that Art. 25 represents the maximum that Member countries are prepared to accept, given that this provision is not yet entirely satisfactory.

Apart from the call for reforms within the confines of the classic “consultation procedure”, there have been repeated calls for the creation of an independent arbitral or judicial court and for the establishment of an advisory body for the settlement of tax disputes.

Certain academics have proposed the creation of a supranational body that competent authorities can request opinions from on the interpretation of a given treaty provision relevant to the case under consideration. In the author’s view, however, both the optional nature of this initiative and the non-binding character of the opinion issued by this body on contracting states, makes such an advisory mechanism insufficient in order to secure an effective solution to the interpretative problem. In particular, the main disadvantage of this proposal is the discretion afforded to the tax authorities, who – as under the mutual agreement procedure – are under no duty to resolve the conflicts that could eventually arise in interpreting and applying tax treaties.

On the other hand, the establishment of an international judicial or arbitral mechanism, demanded in the past by the League of Nations as early as in 1920, has again become an attractive idea that is supported currently in the literature. Different groups of scholars in favour of this thesis can be distinguished depending on whether they argue for the creation of an international tax court *ex novo*, or for an existing judicial court to play a role in the settlement of international tax disputes.

In this respect, even though the plea for a “world tax court” has been reiterated by the IFA, the International Bar Association and the International Chamber of Commerce, among other relevant organizations, and even though there is renewed interest in the legal scholarship, it must be assumed that being the suitable solution in this area, it is also the most difficult one to reach. As Azzi declared, the establishment of “an International Tax Court...
with power to settle international tax disputes would not only lead to the creation of a centralized database of precedents but would also inject uniformity and certainty into this field.

Although this author emphasized the fact that “it is not intended that the proposed International Tax Court usurp the underlying taxing rights of countries but that it merely facilitate the objective and efficient resolution of treaty-related disputes and oversee enforcement of international treaty rulings”, it cannot be expected that such an international body with these characteristics will be established, at least at present, taking into consideration the contracting state’s hesitation to give up part or all of their fiscal sovereignty to a third party and agree, in advance, to abide by the judicial decision.

Based on this reason and the complications that are involved in the creation of such a judicial body, another branch of legal scholarship has approached the problem by focussing on the International Court of Justice (ICJ) and the European Court of Justice (ECJ) as institutions that can play a role in international fiscal dispute resolution. Nevertheless, recourse to such recognized judicial bodies can also pose significant problems that should not be lost sight of, and which are only briefly outlined in this article.19

Considering that the ICJ deals with the broadest scope of questions arising under international law, some practitioners recommend that cases on tax treaty interpretation should be referred to this institution.20 However, the fact that the jurisdiction of the court must be established by way of a compromise between the parties, that its infrastructure is not suited to a large number of cases and, moreover, that it is merely an ad hoc court, whose judges are not international tax experts, explains why not a single known tax treaty interpretation case has been referred to it.

Insofar as the ECJ is concerned, the main objection is that it is merely entitled to act within the territorial scope of the European Union, and therefore would only provide a remedy in the sphere of tax treaties concluded between EU Member States. In any event, the inclusion in the new Austria–Germany tax treaty of a reference to the ECJ for Member States. In any event, the inclusion in the new

The proposal to focus on arbitration is encouraging and arbitration is in fact being defended and illustrated at present by prominent authors26 as an adequate tool in this sphere, however, its non-mandatory character is unsatisfactory. As it is worded, the arbitration clause attributes an absolute discretion to the competent authorities both in respect of submitting the dispute to the arbitrators and abiding by the arbitration award.

In summary, what is remarkable is the fact that although the appropriateness of the arbitration method is not questioned, this mechanism does not ensure that disputes on the contents of a tax treaty can be resolved in all situations.

18. Id.
22. As Maktouf emphasized: “Three decades or so ago, international (...) arbitration was still an intellectual curiosity for the international legal community. (...) Today, over twenty periodicals in various languages deal with arbitration. A multitude of seminars and meetings are organised on the topic. (...) and, mostly important, disputes are increasingly resolved by means by arbitration”. L. Maktouf, “Resolving International Tax Disputes through Arbitration”, Arbitration International 4 (1988), p. 42.
3. A MANDATORY ARBITRATION CLAUSE TO COMPLEMENT THE MUTUAL AGREEMENT PROCEDURE

Using the OECD Model article as a basis for discussion, it is evident that the mutual agreement procedure does not always lead to a satisfactory solution. Thus it is reasonable to conclude that a logical extension must be found.

In the absence of support for instituting an International Tax Court as the optimal solution and taking into account that an arbitration procedure that is dependent on the consent of the competent authorities is not sufficient, the author argues for a system of internationally binding arbitration to supplement the existing “consultation procedure”. It should be borne in mind, however, that mandatory arbitration would be applied not to resolve all cases of double or excessive taxation but only to controversies regarding the interpretation or application of the treaty. Moreover, the compulsory arbitration proposed should be structured to complement the mutual agreement procedure, since a matter may only be submitted to arbitration after exhausting the mutual agreement procedure and provided the tax authorities and the taxpayer have previously agreed to invoke arbitration in these circumstances and be bound by the final award.

As a permanent international arbitral body does not constitute a viable option for the moment, supranational boards should instead be set up on a case-by-case basis. Thus, the arbitration commission would only be constituted for the particular conflict. In contrast to the existing dispute resolution method, which unfortunately does not provide a time frame for the competent authorities to reach agreement, the author proposes that arbitration would be resorted to after a year has elapsed without a solution through the mutual agreement procedure.

In order for a compulsory arbitration system to be realized, Art. 25(3) OECD Model should be amended to include an obligation for contracting states to submit the issue to the tax arbitrators if they are unable to agree in a more amicable manner. The model clause suggested might read as follows: “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. If no settlement can be reached by the Contracting States within one year, the case must be submitted to an ad hoc arbitration commission, consisting of three members appointed in advance from a selected list of international tax experts, which must render its decision within six months. The arbitration award is binding on both States and the taxpayer(s) involved in the case, provided the competent authorities and the taxpayer have agreed in writing to be bound by the decision of the arbitration board. Likewise, the Contracting States may also consult together in order to eliminate double taxation in cases not provided for in the Convention”. As regards the detailed rules governing the arbitration procedure, these would only come into effect once the parties have so agreed through an exchange of diplomatic notes. In the author’s view, it would be desirable to apply the existing procedural rules contained in recent tax treaties, subject to minor modifications. In particular, the arbitration board should be composed of three impartial members. Each tax authority will appoint one arbitrator from a limited list of international tax specialists previously nominated by the contracting states. These members will jointly elect one additional person to act as a chairperson.

Once installed, the arbitration board will decide the specific case on the basis of the tax treaty, giving due consideration to the domestic laws of the parties and the principles of international law. The tax arbitrators will provide to the competent authorities an explanation of their decision, which is binding on both the contracting states and the taxpayer with respect to that case. In this respect, no appeal will be possible on substantive issues.

Accordingly, the major difference between this proposal and the procedure designed by the EC Arbitration Convention of 1990, is the fact that under the latter the competent authorities may make a decision that departs from the Arbitration Committee’s opinion, provided agreement that eliminates double taxation is reached within a time limit of six months after the former advisory opinion is rendered. In the author’s view, in contrast to the EC Arbitration Convention, the pure compulsory arbitration recommended here has two advantages. First, it provides...
an incentive for the contracting states to resolve the issue quickly through the mutual agreement procedure. Secondly, there is no possibility for the parties to enter into further consultations for an additional period of six months, which will unnecessarily delay the outcome.

One of the important aims of compulsory arbitration is to foster uniformity in the interpretation of identical treaty provisions. For that purpose the arbitrator’s award should be published in an English standard format. Even though the decision will not be precedential, it could be used in subsequent similar cases where appropriate. Furthermore, the costs of the arbitration procedure will be borne in the following manner: each contracting state will bear the costs of the member appointed by it, as well as for its representation in the proceedings before the arbitration tribunal. All other costs will be shared equally between the contracting states.

In conclusion, although the international tax community has witnessed few arbitration cases so far, the recent inclusion of voluntary arbitration clauses in tax treaties represents a considerable trend, and consequently a reason to be optimistic that there will be further action in this field. It is therefore hoped that the experience obtained under this system will convince the sovereign states that they have nothing to fear and much to gain from compulsory arbitration as a subsidiary mechanism to guarantee the resolution of tax treaty interpretation divergences once the mutual agreement procedure has proven unsuccessful.