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**YOU CAN'T ALWAYS GET WHAT YOU WANT:
Analysing the effectiveness of the OECD's arbitration protocol
in the Model Double Tax Convention**

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Abstract

This paper explores the addition of arbitration into the Mutual Agreement Procedure of the OECD's Model Double Tax Convention. Through a critical analysis of the provisions it determines that the arbitration clause does not uphold the core tenets of arbitration. The provisions is more akin to fact finding or an advisory opinion. It is suggested that this is an unsatisfactory state of affairs. The purpose of implementing the arbitration provision was to provide for effective and efficient dispute settlement—the result however, is vastly different. The provision is not completely condemned however. This paper suggests a number of improvements to the provision including binding arbitration, a waiver to further remedies and publication of arbitral awards. It is suggested that these improvements will facilitate effective and efficient dispute settlement and progress the OECD's nascent proposal into a cornerstone of international tax disputes.

Keywords: *Double Tax Agreement, Mutual Agreement Procedure, Arbitration, OECD, Model Double Tax Convention*

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I Introduction

Globalisation has led to a rise in cross-border trade and commerce. The collision between international transactions and national interest however, may impose the burden of double taxation on taxpayers as each state vies for its piece of the global tax pie.¹ Double taxation can hamper economic activity and impede business confidence due to the misallocation of resources.² Recognising the harm caused by double taxation, states have attempted to address the issue through the introduction of Double Tax Agreements (DTAs).³ These DTAs create a permissive allocation of each states tax rights.

While states may agree to the form and wording of the DTA, their interpretations may differ. Foreshadowing these differences of interpretation and application most DTAs contain dispute resolution clauses. Traditionally these have provided for negotiation, between the two states party to the treaty, in order to seek an agreed position on taxation. A relatively recent introduction into the Organisation for Economic Co-operation and Development's (OECD) Model Double Tax Convention (MDTC) is arbitration.⁴

The latest MDTC provides that:⁵

any unresolved issues arising from the case shall be submitted to arbitration if the [taxpayer] 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 [taxpayer] 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 aim of this paper is to assess the introduction of this arbitration provision for its effectiveness in resolving taxation disputes. In this endeavour this paper will focus on the

¹ Clinton Alley and others *New Zealand Taxation 2008: Principles, Cases and Questions* (Thomson Brookers, Wellington, 2008) at 669; and Allison Christians "How Nations Share" (2012) 87 *Ind L J* 1407 at 1408.

² Christians, above n 1, at 1414.

³ Charles Irish "Private and Public Dispute Resolution in International Taxation" (2011) 4 *Contemp Asia Arb J* 121 at 132.

⁴ OECD Articles of the Model Convention with Respect to Taxes on Income and on Capital 2008; Richard Coombes "How to Get the Right Results through MAP" (2008) 19 *ITR* 15 at 17; Micah Burch, Luke Nottage and Brett Williams "Appropriate Treaty-Based Dispute Resolution for Asia-Pacific Commerce in the 21st Century" (2012) 35 *UNSWLJ* 1013 at 1041.

⁵ OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(5).

MDTC as it is regarded as the template for the majority of DTAs in effect and heavily influences other model DTAs.⁶

In Part II of this paper I will discuss the history, nature and proliferation of DTAs in international relations, including New Zealand's experience with these agreements. In Part III I will discuss what happens when a taxpayer believes that they have not been taxed in accordance with the DTA and the traditional dispute resolution mechanism available—the Mutual Agreement Procedure (MAP). In Part IV of this paper I will then assess the general nature of arbitration, before evaluating the arbitration provisions of the MDTC in Part V. This will provide a foundation for the critical assessment in Part VI of whether or not the arbitral procedure in the MDTC is really even arbitration. Finally in Part VII, I will suggest some ways to overcome the deficiencies that will be identified. These recommendations will form the basis of a *sui generis* arbitral regime that, while respecting the irreducible elements of arbitration, caters for the intricacies of competing sovereign claims and unique international tax concerns.

II Double Tax Agreements

International law provides no definition of the jurisdictional boundaries on the prerogative to collect tax.⁷ As such there may be overlapping exercises of jurisdiction (often on the equally permissible basis of source or residence taxation) to collect tax on the same income.⁸ To avoid this overlap tax rights were defined by a series of rudimentary soft law agreements between states. This agreement was facilitated by model treaties in international institutions like the OECD and the United Nations (UN).⁹ These model treaties, can be usefully described as soft law. Although they are capable of being incorporated in full by the adopting state there is no obligation to do so. Furthermore, although founded in consensus, these agreements do not impose a legal obligation on the state to respect the OECD or UN model.¹⁰ A state is free to reject international consensus

⁶ Allison Christians “Networks, Norms, and National Tax Policy” (2010) 9 Wash U Global Stud L Rev 1 at 15; David Rosenbloom and others “The Unworldly World of Tax: A Proposal for an International Tax Cooperation Forum” (2014) 15 Fla Tax Rev 57 at 61; and Victor Thuronyi “International Tax Cooperation and a Multilateral Treaty” (2001) 26 Brook J Intl L 1641 at 1641.

⁷ Alley and others, above n 1, at 669; Christians, above n 1, at 1414; and Sharon A Reece “Arbitration in Income Tax Treaties: To Be or Not to Be” (1992) 7 Fla J Intl L 277 at 277.

⁸ Alley and others, above n 1, at 669.

⁹ Christians, above n 1, at 1409.

¹⁰ Allison Christians “Hard Law, Soft Law and International Taxation” (2008) 25 Wis Intl L J 325 at 331.

and bargain for stronger positions with other states.¹¹ These model treaties will however, form hard law once they form the basis of a DTA between states or are incorporated domestically so as to be enforceable.¹²

A further benefit of DTAs is the possibility of greater enforcement of tax obligations.¹³ The common law default rule is that “no country enforces the revenue laws of another”.¹⁴ The rule against enforcement of foreign revenue law remains part of the contemporary law of Anglo-Commonwealth countries.¹⁵ The exercise of enforcement jurisdiction in tax matters is strictly territorially limited.¹⁶ DTAs can function to alleviate the obstruction of the rather strictly applied common law rule and allow for greater cooperation between states in the collection of taxes.¹⁷ The negotiation of DTAs provides both states with an opportunity to set the appropriate boundaries of cooperation and ensure reciprocity in revenue collection.¹⁸ Furthermore, DTAs ensure that revenue based policy remains in the control of the executive.¹⁹

While there are many benefits to DTAs the road to the current MDTC has been a long one. This part of the paper will focus on the history, origins and acceptance of DTAs. An understanding of the importance of DTAs is essential when assessing the need for a structured dispute resolution process.

¹¹ Christians, above n 1, at 1450.

¹² Christians, above n 10, at 331.

¹³ Alley and others, above n 1, at 667.

¹⁴ *Brokaw v Seatrain UK Ltd* [1971] 2 QB 476 (CA) at 483 per Denning MR.

¹⁵ Campbell McLachlan *Foreign Relations Law* (Cambridge University Press, Cambridge, 2014) at [11.91].

¹⁶ See for example: *Holman v Johnson* (1775) 1 Cowp 341, 343, 98 ER; *Government of India v Taylor* [1955] AC 491, (1955) 22 ILR 286 (HL); and *United States of America v Harden* [1963] SCR 366, (1963) 42 ILR 114.

¹⁷ *Avowal Administrative Attorneys Ltd v North Shore District Court* [2008] 1 NZLR 675 at [21]; McLachlan, above n 15, at [11.93]–[11.99]; and OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 27.

¹⁸ McLachlan, above n 15, at [11.99].

¹⁹ McLachlan, above n 15, at [11.99].

A History and Origins of DTAs

Early agreements were initiated on an ad hoc basis—often when concerns were raised by one state as to the effect of foreign taxes on that state's nationals.²⁰ There was apprehension about the effect double taxation would have in building a strong economy and prosperous state. As early as the Bretton Woods agreement, which resulted in the General Agreement on Tariffs and Trade (GATT) in 1945, the economic harm of tariffs was recognised.²¹ This same theory was applied to competing taxes.

Historically there has been no explicit consensus as to the scope of a state's right to tax. There has however, been general agreement that in order to facilitate economic growth taxes should be coordinated between states to ensure that they do not overlap. One of the earliest signs of agreement was the Washington Consensus. The Washington Consensus was a framework in which the US Government and international financial institutions based in the US, such as the International Monetary Fund and the World Bank, adopted several economic policies designed to support business and economic confidence.²² At the heart of this agreement was an emphasis on the importance of macroeconomic stability for the development of the global economy;²³ including stabilising and potentially reforming tax policy.²⁴ There were also general moves to increase each state's tax base.²⁵ The desire to increase the tax base had to develop in harmony with the overarching goal of economic development. As such there needed to be further agreement on which states can lay a claim to which income.

A collection of international organisations have recognised this desire for international agreement.²⁶ The OECD—in which membership includes states and interested groups such as business lobby groups and sector representatives—has been fundamental in the

²⁰ Andrew Smith “A History of New Zealand's Double Tax Agreements” (2010) 16 *New Zealand Journal of Taxation Law and Policy* 105 at 107.

²¹ Christians, above n 1, at 1412; and General Agreement on Tariffs and Trade 55 UNTS 188 (opened for signature 30 October 1947, entered into force 1 January 1948).

²² Deepal Lal “Is the Washington Consensus Dead” (2012) 32 *Cato J* 493 at 494.

²³ John Williamson “A History of the Washington Consensus” (2009) 15 *Law Bus Rev Am* 7 at 8; and Joseph J Norton “Introduction: The Washington Consensus Redefined” (2009) 15 *Law Bus Rev Am* 163 at 163.

²⁴ Lal, above n 22, at 494; and Williamson, above n 23, at 9.

²⁵ Williamson, above n 23, at 9.

²⁶ Christians, above n 1, at 1410.

development of soft law instruments in international tax law.²⁷ The OECD's MDTC is the primary template for DTAs worldwide.²⁸

1 Road to the OECD MDTC

The origin of model tax treaties can be traced back to the League of Nations.²⁹ The underlying rationale for drafting tax treaties was that agreement on taxing rights would facilitate further economic development.³⁰ The League of Nations consultation process resulted in two major model tax treaties: the Mexico Model and the London Model.³¹ Each of these treaties represented the ideas of less developed and more developed nations respectively. The two documents were published by the League of Nations and were the primary guide for tax treaties until 1963.³²

The OECD's first MDTC in 1963 was in essence that which was produced by the OECD's predecessor, the Organisation for European Economic Cooperation (OEEC).³³ This document was the result of 15 Working Parties of the Fiscal Committee of the OEEC. The Working Parties were each made up of two states and each report back to a complete Fiscal Committee.³⁴ While these working parties did not have input from outside groups like the OECD enjoys today (for example business groups and sector representatives) the Fiscal Committee was initiated at the urging of the International Chamber of Commerce—the representative body of the worldwide business community.³⁵

²⁷ Richard Hammer and Jeffrey Owens "OECD Promoting Tax Competition" (2001) 12 Intl Tax Rev 45 at 45.

²⁸ Christians, above n 6, at 15; Rosenbloom and others, above n 6, at 61; Thuronyi, above n 6, at 1641; and Burch, Nottage and Williams, above n 4 at 1039.

²⁹ John Avery Jones "Understanding the OECD Model Tax Convention: The Lesson of History" (2009) 10 Fla Tax Rev 1 at 3; Donald Whittaker "An Examination of the OECD and UN Model Tax Treaties: History, Provisions and Application to US. Foreign Policy" (1983) 8 N C J Intl L & Com Reg 39; and Michelle Bertolini and Pamela Weaver "Mandatory Arbitration within Tax Treaties: A Need for a Coherent International Standard" (2013) 11(2) ATA Journal of Legal Tax Research 1 at 3.

³⁰ Whittaker, above n 29, at 43; and Gustaf Lindencrona "How to resolve International Tax Disputes? New Approaches to an Old Problem" (1990) 5 Intertax 266.

³¹ Whittaker, above n 29, at 43.

³² Whittaker, above n 29, at 44.

³³ Jones, above n 29, at 3.

³⁴ Jones, above n 29, at 4.

³⁵ Lindencrona, above n 30, at 272.

The latest MDTC was released in 2014.³⁶ Further consultation for amendment is ongoing under the Base Erosion and Profiting Shifting project.³⁷ The way in which the OECD finalises the MDTC is of particular importance as it can influence the final result. The aggregate of opinion and preference exposed through negotiations and discussion of the members, in the most part, determines the scope and content of international tax law.³⁸ When considering the most recent amendments it is important to consider those who are now influencing the development of the MDTC. When the first MDTC was released it was a product of negotiation between states only. The current makeup of the OECD includes stakeholders such as the Business Industry and Trade Union Advisory Committees.³⁹ These groups represent interests which are often different to those of the states. Therefore much more development has been seen recently on what would be called a 'pro business' level. Indeed, the ICC has been pushing for different amendments to the OECD MDTC for some time including the incorporation of arbitration provisions.⁴⁰

2 *Early dispute resolution provisions—a forerunner to MAP*

A common thread in all model tax treaties has been a commitment from states to taxpayers that taxpayers would have the right to petition states to resolve double taxation. This was difficult for some states to accept and in some instances states did not conclude treaties for fear that challenges to their right to tax would be questioning their sovereignty.⁴¹ This taxpayer petition generally took the form of a request triggering negotiations between the two states party to the DTA. Some commentators have indicated that early dispute resolution articles were not well considered. In early model treaties it was never thought necessary for a supranational body to decide interpretation issues, due to the relatively insignificant extent to which tax treaties were operating in the early stages.⁴²

³⁶ OECD Model Convention with Respect to Taxes on Income and Capital 2014.

³⁷ See for example Jasmin Kollmann and others "Arbitration in International Tax Matters" (March 2015) Tax Notes International; and OECD *BEPS Action 14: Make Dispute Resolution Mechanisms More Effective* (Public Discussion Draft, December 2014).

³⁸ Burch, Nottage and Williams, above n 4, at 1039. See also "Decision Making in the OECD" below at page 22.

³⁹ OECD "Members and Partners" <www.oecd.org>.

⁴⁰ International Chamber of Commerce *Arbitration in International Tax Matters* (Policy Statement, 3 May 2000) at 1.

⁴¹ See the dissolution of the multilateral agreement between Italy, Hungary, Poland Romania and Yugoslavia in 1922; and Bertolini and Weaver, above n 29, at 3.

⁴² Lindencrona, above n 30, at 266.

That being said, some bilateral treaties did specifically consider the best way to resolve interpretation issues. Arbitration was, for a period, used significantly and in a complementary fashion to negotiation between the contracting states.⁴³ The proliferation of tax treaties soon changed this however. The main dispute mechanism became one which authorised the states to negotiate with each other and agree on the correct interpretation of the particular tax treaty in the case of the particular taxpayer. These negotiation practices eventually crystallised into a set of rules which gradually became the norm in subsequent treaties.⁴⁴ This negotiation procedure was outlined in the OECD's first MDTC in 1963 as the MAP procedure.

3 International acceptance of DTAs

While there may be a general acceptance of DTAs, the resolution of double taxation does not necessarily require international cooperation. States may offer unilateral solutions to the problem of double taxation.⁴⁵ This may be through a tax exemption or by providing a credit against domestic taxes. While these solutions may eliminate the double taxation incurred by the taxpayer they may also be detrimental to the revenue base of the state granting the unilateral relief.

These unilateral approaches may also increase the instances of states "gaming" each other. Gaming may happen when one state offers a tax exception for its tax residents working in foreign state. The foreign state will increase the tax rates on the foreign tax resident to increase its tax revenue. For example, a New Zealand tax resident travels to Australia to work. As a result of the combination of source and residence taxation the taxpayer may be liable to pay tax in both countries. Because of this, New Zealand may grant a credit for the tax paid in Australia against New Zealand tax payable on that income. In theory Australia could 'game' New Zealand's foreign tax credit rules by increasing its tax on the New Zealand resident up to the amount of the New Zealand tax credit. Australia's doing so would create a wealth transfer straight from New Zealand to Australia; in essence increasing the tax revenue and base of Australia at the expense of New Zealand.

A further ancillary effect is that a taxpayer may gain a perceived windfall and in some cases, may end up paying no tax at all. For example, if New Zealand provides a tax exemption to a New Zealand resident taxpayer on income earned in Germany, yet Germany

⁴³ Lindencrona, above n 30, at 267.

⁴⁴ Lindencrona, above n 30, at 267.

⁴⁵ Christians, above n 1, at 1417.

also provides an exemption from income tax for non-residents, the taxpayer effectively pays no tax on the income earned in Germany, as both states are giving tax exemptions. Because of these difficulties in policing accurate and workable unilateral solutions, cooperation between states has become a preferred option for dealing with issues of double taxation.⁴⁶

DTAs are bilateral agreements in which the states agree to the taxation and exemptions that will apply to taxpayers in their respective jurisdictions.⁴⁷ The main function of these treaties is to allocate the right to tax between the states. Taxpayers are generally provided with the right to challenge tax authorities' interpretations of these agreements and their resulting tax practices, if they are not in accordance with the agreements. The hope is that these agreements provide each state its fair share of the tax revenue from opening its borders and facilitating the movement of goods, services and skills in the economy.⁴⁸

4 New Zealand's experience with DTAs

New Zealand's early income tax system was inherited from the United Kingdom and was a territorial income tax—i.e. tax was imposed on New Zealand sourced income only.⁴⁹ As a result income earned in other jurisdictions was of little consequence to the tax authorities of the time and New Zealand tax residents were not often troubled by double taxation.⁵⁰ It was not until 1916 that New Zealand moved to a system of worldwide taxation of residents. This system, at times, resulted in an effective tax rate of over 100 per cent.⁵¹ The only exception to this worldwide tax was the Dominion Tax exception. This provided that income earned in another jurisdiction within the British Empire, and taxed in that jurisdiction, was exempt from New Zealand tax.⁵² This was an intra-imperial agreement and as such no tax treaty was concluded.⁵³

⁴⁶ Christians, above n 1, at 1419.

⁴⁷ Allison Christians "Your Own Personal Tax Law, Dispute Resolution under the OECD Model Tax Convention" (2009) 17 *Willamette J Intl L Dis Res* 172 at 173.

⁴⁸ Christians, above n 1, at 1412; and Gerrit Groen "Arbitration in Bilateral Tax Treaties" (2002) 30 *Intertax* 3.

⁴⁹ Alley and others, above n 1, at 34; and Smith, above n 20, at 106.

⁵⁰ Smith, above n 20, at 106.

⁵¹ Smith, above n 20, at 106.

⁵² Land and Income Tax Act 1916, s 92.

⁵³ Peter Harris "A Historic View of the Principle and Options for Double Tax Relief" (1999) 6 *BTR* 469 at 476.

As a result of New Zealand's status as a capital importing economy the tax laws often differed from those of major trading partners in Europe—who were often capital exporting economies.⁵⁴ This would often result in less favourable tax obligations for companies, and indeed individuals, of New Zealand's major trading partners. As a result of opposition from foreign states to New Zealand's taxation scheme, the Land and Income Tax Amendment Act 1935 was passed. This provided the Governor-General in Council with the ability to exempt the profits of non-resident traders from New Zealand tax if the Governor-General was satisfied that New Zealand residents were similarly exempt in the traders home state.⁵⁵ This relief was not conditional on a negotiation between New Zealand and its trading partner or on a treaty being signed. In the years from 1936–1946, seven such exemptions were promulgated.⁵⁶ While these arrangements were extraordinarily limited when compared with the New Zealand's modern DTAs, they exemplify the importance placed on relieving double tax.

Since the end of the Second World War New Zealand has accepted the utility of wider ranging DTAs. Early DTAs were concluded with the United Kingdom and the US.⁵⁷ After the Gibbs Committee—which was a committee established to provide guidance on the introduction of a new taxation scheme to increase economic growth—released its final report, it was clear that international double taxation was still a serious problem to New Zealand's status as a preferred trading partner.⁵⁸ As a capital importing country however, New Zealand remained reluctant to relinquish its tax base. After its accession to the OECD in 1973, New Zealand has had to reconsider its position.

The primary objective for New Zealand entering into DTAs is to “provide relief from inevitable double taxation”.⁵⁹ Generally all DTAs to which New Zealand is a party provides relief in three ways:⁶⁰ a) by allocating tax rights to one of the two contracting states, b) by limiting the amount of tax that the source country can impose, or c) by requiring the taxpayer's resident state to provide a tax credit on any foreign tax paid.

⁵⁴ Smith, above n 20, at 107.

⁵⁵ Land Income Tax Amendment Act 1935, s 11.

⁵⁶ Those were: Belgium, Switzerland, Indonesia, Japan, Czecholovakia, the United Kingdom and Canada. See Smith, above n 20, at 107.

⁵⁷ Smith, above n 20, at 108.

⁵⁸ Smith, above n 20, at 110.

⁵⁹ Alley and others, above n 1, at 669.

⁶⁰ Alley and others, above n 1, at 669.

Since New Zealand's accession to the OECD the number of DTAs in which New Zealand is party has grown considerably. New Zealand currently has 39 DTAs with various trading partners with further DTAs under negotiation.⁶¹ New Zealand continues to use the MDTC as a model for all of its DTAs.⁶²

III Taxation not in Accordance with the DTA

The DTAs function as a framework for the correct allocation of taxing rights for each state party to the economic activity at issue. While the parties will agree on the form of the DTA, the interpretation may not always align. Disputes may arise when there is disagreement as to the interpretation or the characterisation of income. Take the situation of a New Zealand tax resident who goes to the US to produce and record music for an album and earns \$10,000 for doing so. The taxpayer might declare this as income for services provided to the music industry and it is therefore taxable only in New Zealand.⁶³ The US however, might not assess this as income for services provided to the music industry but rather as royalties and demand the appropriate payment of tax in the US.⁶⁴ This illustrates that while the two states may be able to come to an agreement as to the way in which certain income is to be taxed, they may not be able to agree on the classification of certain income streams.

While in many cases there are attempts to define what is meant by the different types of income streams,⁶⁵ disputes are inevitable.⁶⁶ If a taxpayer considers that they have not been taxed in accordance with the DTA they may present their case, within three years of first notification of the taxation, to the competent authority of the contracting state of which the taxpayer is resident.⁶⁷ If this matter cannot be resolved unilaterally (i.e. by the resident state forgoing its claim to the tax revenue) it must be elevated to MAP.⁶⁸

⁶¹ See Inland Revenue Department "Tax Treaties" Tax Policies <www.ird.govt.nz>. At the time of writing a DTA with Samoa had been signed but is yet to enter into force.

⁶² *Chatfield & Co Ltd v Commissioner of Inland Revenue* [2015] NZHC 2099 at [7].

⁶³ Double Taxation Relief (United States of America) Order 1983, sch 1, art 17.

⁶⁴ Double Taxation Relief (United States of America) Order, sch 2, art VIII(2).

⁶⁵ See the definitions in the OECD Model Convention with Respect to Taxes on Income and Capital 2014.

⁶⁶ William W Park "Income Tax Treaty Arbitration" (2002) 10 Geo Mason L Rec 803; Coombes, above n 4, at 15; and Eduard Sporken and Kelly Bouman "Dutch Introduce Welcome Changes to MAP" (2008) 19 Intl Tax Rev 18.

⁶⁷ OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(1).

⁶⁸ OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(1).

A Mutual Agreement Procedure

The most common way of dealing with disputes in DTAs is through MAP.⁶⁹ If a taxpayer considers that they have been subject to taxation that is not in accordance with the DTA, the taxpayer can petition a designated official in their resident state, termed a component authority, for relief.⁷⁰ If the competent authority decides that the complaint has merit, and cannot be resolved unilaterally,⁷¹ then they must present the matter to their foreign counterpart to engage in negotiations and attempt to resolve the double taxation.⁷² The two component authorities then have a duty to “endeavour” to resolve the situation through the MAP process.⁷³

The MDTC gives the competent authorities the ability to conclude MAP cases that can “reasonably be considered to remain within the scope of the tax treaty provision”.⁷⁴ It may therefore seem unlikely that the competent authorities would have the ability to settle a MAP case which avoided double taxation but was in contradiction to the strict application of the DTA. The OECD has attempted to find a solution to this potentially unsatisfactory restriction however. Where the articles of the DTA are preventing an agreement the competent authorities may “have regard to equity in order to give the taxpayer satisfaction.”⁷⁵ A taxpayer may therefore be subject to taxation that is not in accordance with the DTA but is a satisfactory resolution for the taxpayer.

MAP is designed to absolve the taxpayer of the need to go through litigation or to petition the tax authorities in both states to ensure taxation in accordance with the DTA.⁷⁶ It is designed to be a process which facilitates fast and effective resolutions to interpretation

⁶⁹ Coombes, above n 4, at 15; Sporken and Bouman, above n 66, at 18; and Groen, above n 48, at 4.

⁷⁰ In most states the competent authority is an official within the internal tax authority. In New Zealand the competent authority is the Commissioner of the Inland Revenue Department or their nominated representative. The nominated representative at the time of writing was John Nash, Manager (International Revenue Strategy).

⁷¹ OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(2).

⁷² Groen, above n 48, at 4.

⁷³ OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(2); Burch, Luke and Williams, above n 4, at 1040; Micah Burch and Luke Nottage “Novel Treaty-Based Approaches to Resolving International Investment and Tax Disputes in the Asia-Pacific Region” (2011) 18 *Austl Intl L J* 127 at 134; Christians, above n 47, at 172; Groen, above n 48, at 5; OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(3); and see Appendix One.

⁷⁴ Groen, above n 48, at 5 (emphasis omitted).

⁷⁵ OECD “Commentaries on the Articles of the Model Tax Convention” article 25 at [38].

⁷⁶ OECD “Commentaries on the Articles of the Model Tax Convention” article 25 at [7].

disputes between the two contracting states.⁷⁷ MAP negotiation, in most cases, does not deprive the taxpayer of the right to litigate in domestic courts,⁷⁸ but it is often a preferred remedy because of the cost of litigation. If the two competent authorities can reach a mutually agreeable interpretation of the treaty there should, in theory, be movements by both or just one of the tax authorities to ensure that a taxpayer only pays tax in accordance with the DTA.⁷⁹ If however, the two competent authorities cannot come to an agreement, litigation may be the only available option to taxpayers to avoid double taxation.⁸⁰ Fundamentally, MAP is a negotiation between the two states to agree on the tax take in any particular situation.⁸¹ The process however, has not escaped criticism. With the under resourcing of MAP cases and the exclusion of potentially valuable input from the taxpayer, many shortcomings in the MAP procedure have been identified.

B Concerns with MAP

MAP has been described as “old fashioned and slow” when dealing with complaints from taxpayers.⁸² While this may not be an entirely fair assessment of the process itself, as some of the concerns can be attributed to the state parties negotiating the dispute, there are some clear issues with MAP as a dispute resolution mechanism in international tax law.

1 Delays

The reluctance of competent authorities to depart from their own domestic rules regarding tax obligations can cause a stalemate in some situations, leaving the taxpayer with no relief.⁸³ While it may not yet be a significant problem in New Zealand,⁸⁴ larger states are facing a substantial backlog of MAP cases.⁸⁵ In 2013 alone, there were over 1910 new claims in OECD member states and 4566 unresolved MAP cases.⁸⁶ The number of MAP cases combined with the average length of time to resolve the disputes (23.2 months in

⁷⁷ See generally OECD “Commentaries on the Articles of the Model Tax Convention” article 25.

⁷⁸ OECD “Commentaries on the Articles of the Model Tax Convention” article 25 at [7].

⁷⁹ Coombes, above n 4, at 15.

⁸⁰ Sporken and Bouman, above n 66, at 19.

⁸¹ Sporken and Bouman, above n 66, at 18.

⁸² Coombes, above n 4, at 17.

⁸³ Coombes, above n 4, at 17.

⁸⁴ Only 42 requests for MAP have been received by the New Zealand Competent Authority from 2006–2013, see OECD “Mutual Agreement Procedure Statistics for 2013” <www.oecd.org>.

⁸⁵ Burch, Luke and Williams, above n 4, at 1040; Christians, above n 47, at 178; and Joe Dalton “Unlocking MAP Disputes: Is Mediation the Key?” (2013) 24 Intl Tax Rev 14 at 15.

⁸⁶ OECD “Mutual Agreement Procedure Statistics for 2013” <www.oecd.org>.

2013) presents a significant problem for taxpayers.⁸⁷ One reason for the delay is the increased use of MAP as a dispute resolution tool. There are only limited resources to finance and facilitate the MAP process. Each new case adds an extra burden onto already limited resources. Furthermore, there is an increase in the number of states who are beginning to engage in the MAP process, often from less developed areas which can cause significant delays.

States without experience in the MAP process, or highly technical tax issues such as transfer pricing, are naturally slower at resolving cases. This has flow on effects for the other contracting state and their backlog of cases.⁸⁸ This can have wider ramifications than just the MAP procedure. Oftentimes relationships between competent authorities have been considerably strained because of the time it takes to resolve some cases.⁸⁹ This may affect future working relationships and opportunities to agree in advance to certain cases to help avoid further MAP cases, such as the creation of advance pricing agreements.

The MAP process should be fast and efficient at resolving disputes. One of the main reasons for the accumulation of unresolved MAP cases is that the competent authorities must only “endeavour” to reach a resolution.⁹⁰ There is neither an obligation nor any sanction for failing to resolve a particular case.⁹¹ Through MAP negotiations alone it is possible that disputes will remain unresolved and taxpayers will suffer double taxation, contrary to the very purpose of the DTA.⁹² There is often little or no motivation for competent authorities to expedite the process.⁹³ While this does not leave the taxpayer without further remedy, as they still have recourse to domestic courts,⁹⁴ it does put them in a precarious position. Considerable resources must be expended to receive a judgment and

⁸⁷ Dalton, above n 85, at 15.

⁸⁸ Dalton, above n 85, at 15.

⁸⁹ Dalton, above n 85, at 15.

⁹⁰ OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(2); Burch, Luke and Williams, above n 4, at 1040; Burch and Nottage, above n 73, at 134; and Christians, above n 47, at 172.

⁹¹ Lindencrona, above n 30, at 266; Guillermo Campos “Treaty Provision for the Arbitration of Transfer Pricing Disputes” (1996) 10 Intertax 370 at 371; Park, above n 66, at 809; and Christians, above n 47, at 180.

⁹² Campos, above n 91, at 371.

⁹³ Michelle Markham “The Resolution of Transfer Pricing Disputes Through Arbitration” (2005) 33 Intertax 68; and Park, above n 66, at 809.

⁹⁴ OECD “Commentaries on the Articles of the Model Tax Convention” article 25 at [7].

there is no guarantee that this would not be appealed by the state if an adverse ruling was delivered.⁹⁵

2 *No taxpayer involvement*

Furthermore, there is no direct taxpayer involvement in the MAP negotiations and the taxpayer does not have an automatic right to submit their case, or interpretation of the treaty, to the competent authorities.⁹⁶

While the theoretical basis may be that the taxpayer does not concern themselves with who gets the right to tax their income, so long as the double taxation is resolved, this does not hold weight after further investigation.⁹⁷ The two states may be claiming competing classifications of income which may attract varying tax rates. Furthermore, the DTA creates a permissive regime not a prescriptive one. The state has a *right* to tax not an *obligation* to tax. All three parties (the two states and the taxpayer) have unique and often competing interests in the resolution of the dispute.⁹⁸

While the taxpayer may be asked to provide extra information, MAP remains a “strictly intra-governmental” process.⁹⁹ While it is in the best interests of the taxpayer to provide as much information as requested by the competent authorities, taxpayers may be weary of this as it may amount to what some have called a “joint audit” on the taxpayer.¹⁰⁰ This unsatisfactory situation has led taxpayers, especially large taxpayers, to lobby for a more effective dispute resolution mechanism.¹⁰¹

3 *Lack of guidance from previous MAP cases*

The taxpayer's claim may also be subject to intergovernmental “horse trading ... [as competent authorities] might be tempted to sacrifice a taxpayer in one dispute as a bargaining chip in another case”.¹⁰² The opportunities for the taxpayer to exert influence

⁹⁵ Campos, above n 91, at 371.

⁹⁶ Coombes, above n 4, at 15.

⁹⁷ Richard Caves *Multinational Enterprise and Economic Analysis* (3rd ed, Cambridge University Press, Cambridge, 2007) at 223.

⁹⁸ Christians, above n 1, at 1423.

⁹⁹ Coombes, above n 4, at 15; and Christians, above n 1, at 1424.

¹⁰⁰ Burch, Luke and Williams, above n 4, at 1040.

¹⁰¹ Burch, Luke and Williams, above n 4, at 1040.

¹⁰² Park, above n 66, at 804; and Burch, Luke and Williams, above n 4, at 1040.

on the MAP are relatively few in an often highly confidential process between the two states.¹⁰³ The number of cases that are decided through MAP represents a potentially significant amount of tax law that is being decided by the competent authorities of each state in private negotiations without input from those affected.¹⁰⁴ This is particularly troubling as the decisions that are made in one MAP do not apply to other like cases, nor do they necessarily influence the competent authorities in future MAP negotiations.¹⁰⁵

Negotiations and other decisions that deviate from the internal regulatory regime create a deficiency in knowledge for taxpayers. They are deprived of critical information to make a planned and educated assessment of the tax system as a whole and the tax burden that will likely be imposed.¹⁰⁶ States may want to continue to bargain for stronger positions, irrespective of what has previously been decided, thus drawing out the process.¹⁰⁷

C Domestic Enforceability of DTAs

As previously alluded to the MAP process is not the only remedy available to a taxpayer. DTAs also form a part of domestic legislation and are therefore subject to the jurisdiction of the domestic court.¹⁰⁸ New Zealand follows many other jurisdictions in providing that the DTA will take precedence over domestic legislation detailing tax obligations.¹⁰⁹ So if a conflict arises between the Income Tax Act 2007 and the DTA the provisions of the DTA will prevail. The taxpayer must be careful about choosing to pursue domestic remedies however, as they may have an effect on whether the taxpayer can then progress to MAP or arbitration.¹¹⁰

The MAP process falls short of what is required for an effective dispute resolution mechanism.¹¹¹ It is “rooted in antiquated principles of international law” that holds that states are the sole subjects.¹¹² As such, the taxpayer has no right to be involved in the

¹⁰³ Burch, Luke and Williams, above n 4, at 1040; and Coombes, above n 4, at 17.

¹⁰⁴ Christians, above n 47, at 178.

¹⁰⁵ Groen, above n 48, at 7.

¹⁰⁶ Christians, above n 1, at 1409.

¹⁰⁷ Campos, above n 91, at 373.

¹⁰⁸ See for example New Zealand Orders in Council incorporating DTAs into New Zealand.

¹⁰⁹ Income Tax Act 2007, s BH1(4).

¹¹⁰ See discussion below “Barriers to Arbitration” at page 31.

¹¹¹ Campos, above n 91, at 371; and Park, above n 66, at 809.

¹¹² Groen, above n 48, at 7.

process and the control is left in the hands of the contracting states.¹¹³ Compared to other processes such as domestic court proceedings where the facts, legal arguments and reasoning are open to the public, the MAP procedure is prone to pragmatic compromise which may not reflect the principle on which the taxpayer's claim was based. Rather than settling a case in a way which protects and respects the application of the DTA, an agreement may be reached which best suits the state irrespective of the interests of the taxpayer or the correct interpretation of the DTA.¹¹⁴ Each competent authority is not bound by the interpretations of the previous MAP case and there may be different negotiating positions dependent on a range of factors such as the opposing state, the potential tax gain or loss in question and the tax policy of the time.

IV Arbitration as a Dispute Resolution Procedure

This part of the paper will look briefly at the proliferation and acceptance of arbitration in international law. It will then focus specifically on the introduction of arbitration into the MDTC.

A A Brief History of International Arbitration

The use of arbitration can be traced back to early accounts of Greek mythology, the Roman Empire and economic disputes in the Middle Ages through the law merchant.¹¹⁵ It is an effective tool at settling disagreements and preserving relationships.¹¹⁶ The Treaty of Amity, Commerce and Navigation between the United States and Great Britain in 1794, more commonly known as Jay's Treaty, included arbitration mechanisms to settle various disputes.¹¹⁷ Jay's Treaty signalled the beginning of a period of acceptance of arbitration as a preferred mechanism to resolve inter-state disputes.¹¹⁸

¹¹³ OECD "Commentaries on the Articles of the Model Tax Convention" article 25 at [10].

¹¹⁴ Liege Scholsem "EC: The Proposal for a Council Directive on the Elimination of Double Taxation (Arbitration Procedure)" (1982) 11 Intertax 424 at 433.

¹¹⁵ Gary Born *International Arbitration: Cases and Materials* (Kluwer Law International, The Netherlands, 2011) at 2–4; Henry Fraser "Sketch of the History of International Arbitration" (1926) 11 Cornell LQ 179 at 185, 190; and Law Commission *Arbitration* (NZLC R20, 1991) at 62.

¹¹⁶ Born, above n 115, at 4; and Michael Mustill "Arbitration: History and Background" (1989) 6(2) Journal of International Arbitration 43.

¹¹⁷ Chittharanjan F Amerasinghe *International Litigation in Practice: International Arbitration* (Martinus Nijhoff Publishers, The Netherlands, 2011) at 7.

¹¹⁸ Born, above n 115, at 5; and Jonathan Charney "Third Party Dispute Settlement and International Law" (1998) 36 Colum J Transnatl L 65 at 68.

The first attempt to unify the rules of inter-state arbitration was the little recognised 1875 project of the Institut de Droit International.¹¹⁹ The Institut acknowledged the growing trend of international arbitration and hoped to encourage its use, and uniformity, by setting forth rules for ad hoc arbitration agreements.¹²⁰ By 1899, with the conclusion of The Hague Convention and the establishment of the Permanent Court of Arbitration (PCA), arbitration had cemented itself as an efficient and preferred method of settling international disputes.¹²¹ Indeed it was explicitly recognised as a favoured method of resolving disputes between states.¹²²

B Introduction of Arbitration into Tax Law

The earliest tax treaties between the United Kingdom and Irish Free State in 1926 incorporated binding arbitral awards.¹²³ Later, the Czechoslovakia and Romania treaty allowed for binding arbitration by the Fiscal Committee of the League of Nations should a dispute arise as to the interpretation of the treaty.¹²⁴ This form of dispute resolution was then overshadowed by MAP.¹²⁵ The OECD was not the first organisation to moot the re-introduction of arbitration as the proper dispute mechanism for tax treaties. The Commission of the European Communities proposed an arbitration procedure in 1976 to the then European Community.¹²⁶ It provided for binding arbitration and mandatory dispute settlement when disputes as to the interpretation of the internal European Community Tax Agreements arose. The arbitral award would have been binding on all states in the European Community.¹²⁷ Ultimately, it was not adopted.

¹¹⁹ Institut de Droit International “Projet de Règlement Pour la Procédure Arbitrale Internationale” Resolution (1875).

¹²⁰ Born, above n 115, at 28.

¹²¹ Born, above n 115, at 28; Charney, above n 118, at 68; and Mustill, above n 116, at 48.

¹²² Convention for the Pacific Settlement of Disputes (July 1899); art 16 which reads:

“In questions of a legal nature, and especially in the interpretation or application of International Conventions, arbitration is recognized by the Signatory Powers as the most effective, and at the same time the most equitable, means of settling disputes which diplomacy has failed to settle.”

¹²³ Agreement between the British Government and the Government of the Irish Free State in Respect of Double Taxation Tax, art. 7, (14, April 1926).

¹²⁴ Convention between the Kingdom of Romania and the Czechoslovak Republic Concerning Double Taxation in Connection With Succession (20 June 1934); Bertolini and Weaver, above n 29, at 4–5; and Lindencrona, above n 30, at 266.

¹²⁵ See discussion above “Early Dispute Resolution Provisions—a forerunner to MAP” at page 10.

¹²⁶ Lindencrona, above n 30, at 268; and Scholsem, above n 114, at 424.

¹²⁷ Lindencrona, above n 30, at 268.

After a prolonged hiatus, arbitration re-emerged in a 2003 OECD questionnaire issued to the business community on dispute resolution mechanisms in the MDTC.¹²⁸ Although predominantly focused on MAP it also invited comment on arbitration and mediation as suitable alternatives or complementary measures.¹²⁹ To understand the significance of this, and the importance of the OECD recognising arbitration as a viable alternative, it is important to take into account the way in which the OECD formulates and agrees upon the contents of the MDTC.

1 Decision making in the OECD

The OECD is organised under the Convention on the Organisation for Economic Co-operation and Development.¹³⁰ The convention envisaged, and the OECD operates, on the basis of consensus among members rather than through a supranational executive.¹³¹ Tax policy is developed by three interconnecting networks within the OECD: the OECD Council, the Centre for Tax Policy and Administration, and the Committee on Fiscal Affairs.¹³² Interested parties from member and non-member states as well as stakeholders (such as the International Chamber of Commerce, the Confederation of British Industry, and other international advocacy groups) influence the development of policy through meetings, conferences and informal gatherings.¹³³

The OECD Council, made up of high ranking member state officials, is responsible for issuing consensus statements about the work and direction of the OECD's tax policy. Policies are then developed by smaller groups that come within the target areas of the Council's statements. In effect the job of the Council is to not mandate specific policy but

¹²⁸ Markham, above n 93, at 68.

¹²⁹ Centre for Tax Policy and Administration "Questionnaire for Business on Procedures for Resolving International Tax Disputes" OECD (2003) at 4 which stated: "Please provide us with your experience, or any views you might have on international tax dispute resolution mechanisms other than MAP (e.g. arbitration or mediation)."

¹³⁰ Convention on the Organisation for Economic Co-operation and Development 1961 UNTS 888 (opened for signature 14 December 1960, entered into force 30 September 1961).

¹³¹ Convention on the Organisation for Economic Co-operation and Development 1961 UNTS 888 (opened for signature 14 December 1960, entered into force 30 September 1961), art 6; Christians, above n 6, at 17; and Rosenbloom and others, above n 6, at 59.

¹³² Christians, above n 6, at 17; and OECD "Who Does What?" <www.oecd.org>.

¹³³ Christians, above n 6, at 17.

to indicate areas for working groups to generate policy which will then be approved by the Council.¹³⁴

The Centre for Tax Policy and Administration is the expert network gathered to negotiate common positions on the Council mandated policy area. These experts are not national representatives but individuals employed by the OECD to formulate policy. Often however, their past experience, regularly in tax departments of member states, will influence their thinking.¹³⁵ The Centre also convenes collaborative meetings with representatives from various interest groups, states and regional groups. A main portion of the Centre's work is to coordinate and manage the work of the Committee on Fiscal Affairs, where the majority of the work is completed.

The Committee is an umbrella entity with working groups reporting to it. The membership of these working groups is much wider than the Council and Centre and is made up of state representatives and independent advisory and representative groups. These working groups hold an important and influential position in crafting the international tax law.¹³⁶ The development of policy by the OECD is not a typical "command-and-control regulation" style, rather it is based on open coordination and agreement between state players.¹³⁷ While there may be participants who can exert more influence than others, the fundamental core of the OECD is that all policy and outcomes are on a consensus basis.¹³⁸ The OECD attempts to facilitate the establishment of patterns and structures for future state behaviour.¹³⁹ Though member states are not bound by what the OECD decides the OECD does attempt to create international norms. It does this through developing what it calls "standards and guidelines" which act as a benchmark in terms of international tax policy which states attempt to reach.¹⁴⁰ There may however, be legitimate considerations for states who oppose the adopted OECD position and in doing so differ in some respects to the MDTC. Nevertheless the incorporation of arbitration into model tax agreements recognises

¹³⁴ Christians, above n 6, at 18.

¹³⁵ Christians, above n 6, at 20.

¹³⁶ Christians, above n 6, at 22.

¹³⁷ Christians, above n 6, at 22.

¹³⁸ Christians, above n 6, at 17; and Rosenbloom and others, above n 6, at 59.

¹³⁹ Christians, above n 1, at 1450.

¹⁴⁰ OECD *OECD's Current Tax Agenda* (June 2010) at 5.

the normalisation of arbitration and the expectation that disputes would be resolved through an adjudicatory method.¹⁴¹

V Arbitration in the MDTC

This part of the paper will focus on the inclusion of arbitration in the MDTC. It will discuss the current arbitration process and the competing methods of arbitration that are available. It will then discuss some of the objections to the implementation of arbitration in the area of tax law before finally moving on to the benefits that arbitration can provide.

A Current Arbitration Model

The current arbitration model, found in art 25 of the MDTC, it provides that:¹⁴²

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.¹⁴³

¹⁴¹ Anna Spain “International Dispute Resolution in an Era of Globalisation” in Andrew Byrnes and others (eds) *International Law in the New Age of Globalization* (Martinus Nijhoff Publishers, Boston, 2013) 41 at 51.

¹⁴² OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(5) (footnotes included).

¹⁴³ In some States, national law, policy or administrative considerations may not allow or justify the type of dispute resolution envisaged under this paragraph. In addition, some States may only wish

1 Arbitration process

The arbitration provision has changed little since its inception in 2008. The process remains fundamentally the same. If a taxpayer believes that they have not been taxed in accordance with the DTA they must first petition the competent authority in the state in which they are tax resident. This will engage the MAP process and the two states will negotiate and endeavour to find a resolution. If there remains any unresolved issues after two years of negotiation the taxpayer may request the two states to go to arbitration to resolve the “unresolved issues”. Once the states have been compelled to enter into arbitration they must agree on the content and scope of the matters that are to be arbitrated and the form that the arbitration will take.

The OECD has provided a model arbitration protocol which sets out all aspects from selection of arbitrators, payment of costs and hearing practices. It is up to the states however, to negotiate the arbitration protocol as they are not bound by the OECD model. Both the arbitration clause and protocol will be assessed in the following sections. Once the arbitral award has been issued the taxpayer may reject or accept this award. If accepted, the two states will incorporate the award into the MAP agreement to resolve the taxation not in accordance with the DTA.

2 Competing arbitration procedures

The OECD provides a sample arbitration protocol. States are free to modify, add or delete any provisions.¹⁴⁴ While many states may use this sample protocol New Zealand’s position is unclear. While there is a skeletal protocol available in the Japan-New Zealand DTA, requests to view the complete arbitration protocol have been denied.¹⁴⁵ There are two competing approaches to arbitration which states may decide to implement.

to include this paragraph in treaties with certain States. For these reasons, the paragraph should only be included in the Convention where each State concludes that it would be appropriate to do so based on the factors described in paragraph 65 of the Commentary on the paragraph. As mentioned in paragraph 74 of that Commentary, however, other States may be able to agree to remove from the paragraph the condition that issues may not be submitted to arbitration if a decision on these issues has already been rendered by one of their courts or administrative tribunals.

¹⁴⁴ OECD “Commentaries on the Articles of the Model Tax Convention” Annex: Sample Mutual Agreement on Arbitration.

¹⁴⁵ Double Tax Agreements (Japan) Order 2013, sch 2.

Independent arbitration allows the arbitrators, presented with the facts and arguments from each state, to reach their own independent decision.¹⁴⁶ The procedure is much like a domestic court litigation. The parties may present written submissions, call witnesses and give oral submissions.¹⁴⁷

The second arbitration method which OECD contemplates is baseball arbitration.¹⁴⁸ Baseball arbitration is a process in which the parties narrow the risk to themselves. This is achieved by limiting the scope of the arbitral award to one of two competing positions; that of State A or State B.¹⁴⁹ In this form of arbitration both parties submit their positions to the arbitrators and the tribunal selects the offer which comes closest to its own interpretation of the DTA.¹⁵⁰ The arbitrators are not required to present their interpretation of the DTA, rather they simply select whichever interpretation, is the closest to their own.¹⁵¹ There is no scope to split the two offers down the middle.¹⁵² While it is useful in that it gets the parties to rationalise their interpretations—as an irrational interpretation is less likely to be selected—these awards are often devoid of legal reasoning, only indicating the decision and not the basis on which the decision was made.¹⁵³

3 *Compulsory nature of arbitration*

Progressing a dispute to arbitration is not dependent on contemporaneous authorisation by the competent authorities, rather there is standing consent to arbitrate any “unresolved issues” once the procedural requirement—two years of MAP—has been met.¹⁵⁴ Like MAP the arbitration provision is initiated at the request of the taxpayer and the contracting states

¹⁴⁶ Born, above n 115, at 8; and Julian Lew, Loukas Mistelis and Stefan Kroll *Comparative International Commercial Arbitration* (Kluwer Law International, The Hague, 2003) at 4.

¹⁴⁷ Alan Redfern and others *Law and Practice of International Commercial Arbitration* (5th ed, Sweet & Maxwell, London, 2009) at 278.

¹⁴⁸ OECD “Commentaries on the Articles of the Model Tax Convention” Annex: Sample Mutual Agreement on Arbitration at 3.

¹⁴⁹ Lew, Mistelis and Kroll, above n 146, at 13.

¹⁵⁰ Lew, Mistelis and Kroll, above n 146, at 13.

¹⁵¹ Lew, Mistelis and Kroll, above n 146, at 13.

¹⁵² James Fuller and Barton Bassett “International Tax Controversies” (2008) 34 *Int'l Tax J* 15 at 16.

¹⁵³ Hugh J Ault “Improving the Resolution of International Tax Disputes” (2006) 7 *Fla Tax Rev* 137 at 149; Lew, Mistelis and Kroll, above n 146, at 13; Fuller and Bassett, above n 152, at 17; and David Rosenbloom “Mandatory Arbitration of Disputes Pursuant to Tax Treaties: The Experience of the United States” (forthcoming).

¹⁵⁴ OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(5)(b) and OECD “Commentaries on the Articles of the Model Tax Convention” article 25 at [63].

are obliged to enter arbitration if so requested.¹⁵⁵ Arbitration is not an alternative procedure for settling disputes, rather it is a subsequent procedure or second step in the process.¹⁵⁶

While it is possible for states to accept arbitration after the conclusion of the DTA,¹⁵⁷ in order for the arbitration provision to be truly effective there needs to be standing consent to arbitration. If the acceptance of arbitration is delayed until after a dispute has arisen then it may be subject to “gamesmanship” between the contracting parties.¹⁵⁸ The current MDTC is effective in this regard as it provides for arbitration which can be compelled by the taxpayer.¹⁵⁹ There may however, be a further deficiency in regards the scope of the arbitration clause and the competence of the tribunal.

4 Subject matter of the arbitration

The arbitration agreement as included in the MDTC envisages that “any unresolved issues” from MAP will be presented to arbitration. This is potentially a very wide and inclusive standing consent. It is the two competent authorities who will decide whether there are any unresolved issues however.¹⁶⁰ The OECD Commentary to the arbitration provision provides that:¹⁶¹

[t]he arbitration process provided for by the paragraph is not an alternative or additional recourse: where the competent authorities have reached agreement that does not leave any unresolved issues as regards the application of the Convention, there are no unresolved issues that can be brought to arbitration even if the person who made the mutual agreement request does not consider that the agreement reached by the competent authorities provides a correct resolution to the case.

It therefore seems that arbitration is not available to settle the interpretation of the DTA when questions are raised by the taxpayer—that there is taxation not in accordance with the DTA—but where the competent authorities consider that the taxation *is* in accordance

¹⁵⁵ OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(5); and Burch, Nottage and Williams, above n 4, at 1041.

¹⁵⁶ OECD Articles of the Model Convention with Respect to Taxes on Income and on Capital 2008, art 25(5); Coombes, above n 4, at 17; and Sporcken and Bouman, above n 66, at 19.

¹⁵⁷ OECD “Commentaries on the Articles of the Model Tax Convention” article 25 at [69].

¹⁵⁸ Park, above n 66, at 804.

¹⁵⁹ OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(5).

¹⁶⁰ OECD “Commentaries on the Articles of the Model Tax Convention” article 25 at [71].

¹⁶¹ OECD “Commentaries on the Articles of the Model Tax Convention” article 25 at [64].

with the DTA. While this at first glance may seem limiting, it is consistent with the nature of DTAs. DTAs are first and foremost bilateral agreements between states. If the states agree to an interpretation, regardless of what a third party believes, there is no dispute between the parties and therefore no basis for arbitration.

What the limit to “unresolved issues” also does is reiterate that arbitration is a second step in the resolution of the dispute and not an alternative dispute resolution mechanism. It is not the whole case that is submitted to arbitration rather only distinct issues that remain unresolved after MAP negotiations. The case as a whole remains within the ambit of the MAP and is settled through that process.¹⁶² The practical effects of this circumscribed jurisdiction may be limited however, as all issues will eventually be resolved—either through negotiation or arbitration. What this serves to illustrate however, is the restricted nature of the arbitration model that has been incorporated by the OECD.

States can further limit the competence of the arbitral tribunal.¹⁶³ Indeed, New Zealand in its DTA with Australia, has altered the scope and competence of the tribunal by providing that arbitration will only apply in respect of:¹⁶⁴

- a) issues of fact; and
- b) issues which the Government of Australia and the Government of New Zealand agree, in an Exchange of Notes, shall be covered by the provisions of paragraph 6 [the arbitration provision].

This has the effect of limiting the mandatory arbitration to issues of fact which may provide little remedy when the issue in dispute is the interpretation of the agreement, or indeed the classification of income which will necessarily involve questions of law.

What this restriction does in essence to the arbitration clause is transform the standing consent clause into an optional arbitration clause. It removes the ability of arbitration to act as a ‘stick’ to resolving the MAP process sooner and has little practical utility.¹⁶⁵ Given that the states are not able to agree on the interpretation of the treaty and the concerns that

¹⁶² OECD “Commentaries on the Articles of the Model Tax Convention” article 25 at [64].

¹⁶³ OECD “Commentaries on the Articles of the Model Tax Convention” article 25 at [66].

¹⁶⁴ Double Taxation Relief (Australia) Order 2010, sch 1, art 25(7).

¹⁶⁵ Sarah G Nowland “Three’s (Not) a Crowd in International Tax Arbitration: International Tax Arbitration as a Development of International Commercial Arbitration Rather than a MAP Fix” (2014) 37 *Hastings Int'l & Comp L Rev* 183 at 191; and Park, above n 66, at 811. See also below “Is This an Effective Arbitration Procedure” at page 34.

many states have with regard to arbitration in the area of tax, explained below, there is enormous risk in relying on this provision and other post dispute arbitration agreement provisions.¹⁶⁶

5 Confidentiality

Confidentiality of arbitral awards is a “contentious and unsettled subject”.¹⁶⁷ While some argue that confidentiality is a key component of arbitration,¹⁶⁸ others argue that it is unnecessary especially given the range of important topics that arbitration traverses and the benefit that would come from the publication of the awards.¹⁶⁹ Inter-state arbitration specifically has been subject to a liberalisation of the principle of confidentiality.¹⁷⁰ Furthermore in *Esso Australia Resources Ltd v Plowman* the High Court of Australia recognised that confidentiality yields to the right of the public to gain information.¹⁷¹ While not dealing specifically with inter-state arbitration the Court did note that the public must be able to obtain information regarding a public authority and the exercise of public power; this right of the public must prevail over the confidentiality of the arbitral proceedings.¹⁷²

New Zealand responded to the *Esso* decision by inserting s 14 into the Arbitration Act which implies a term of confidentiality into arbitration agreements.¹⁷³ Confidentiality of arbitration was further strengthened with the Arbitration Amendment Act 2007 which inserted ss 14A–14H into the Arbitration Act.¹⁷⁴ These sections provide for a comprehensive scheme setting extremely high expectations for the confidentiality of arbitration. The focus of the Arbitration Act is specifically on domestic arbitration however. The Law Commission, which proposed the initial 1996 Act and its 2007 amendments, did not intend the provisions to apply to inter-state arbitration. Indeed the

¹⁶⁶ Park, above n 66, at 811.

¹⁶⁷ Born, above n 115, at 791.

¹⁶⁸ See generally Patrick Neil “Confidentiality in Arbitration” (1996) 12 Arb Intl 287; and Mabel Egonu “Investor State Arbitration under ICSID: A Case for Presumption against Confidentiality” (2007) 24(5) Journal of International Arbitration 479.

¹⁶⁹ See generally Michael Collins “Privacy and Confidentiality in Arbitration Proceedings” (1995) 30 Tex Intl L J 121.

¹⁷⁰ Bernardo Cremades and Rodrigo Cortes “The Principle of Confidentiality in Arbitration: A Necessary Crisis” (2013) 23 J Arb Stud 25 at 27.

¹⁷¹ *Esso Australia Resources Ltd v Plowman* [1995] HCA 19.

¹⁷² Cremades and Cortes, above n 170, at 30.

¹⁷³ Law Commission *Improving the Arbitration Act 1996* (NZLC R83, 2003) at 3.

¹⁷⁴ See generally Law Commission, above n 173.

Law Commission specifically recognised that, appropriately so, different rules apply to the confidentiality of inter-state arbitration.¹⁷⁵

The OECD goes some way to recognising that strict confidentiality is not always appropriate in inter-state arbitrations and that a greater degree of publicness is necessary. The OECD includes, in its sample arbitration protocol, provision for the publication of awards, it states:¹⁷⁶

with the permission of the person who made the request for arbitration and both competent authorities the decision of the arbitral panel will be made public in redacted form without mentioning the names of the parties involved or any details that might disclose their identity ...

As can be seen, while there is provision for the publication of awards, it is very weak. Publication is, in essence, at the approval of the taxpayer, a party who is not directly involved in the arbitration or the DTA. Furthermore, the state parties may be reluctant to allow arbitration awards to be released publicly as this could hamper future negotiation positions. Although the OECD explicitly provides that “the decision has no formal precedential value”,¹⁷⁷ tribunals in other fields have shown “a high degree willingness to draw upon previous awards” which may hinder states bargaining positions in future MAP negotiations and arbitrations.¹⁷⁸

New Zealand seems to be pursuing a stricter position on confidentiality. The parts of the New Zealand-Japan protocol that are available do not contemplate any publication of an award.¹⁷⁹ Article 27 of the DTA states that all information provided in arbitration is to be treated as secret and only disclosed for the purposes of assessment or collection of taxes. This also applies to all individuals associated with the arbitration who must sign

¹⁷⁵ Law Commission, above n 173, at [22].

¹⁷⁶ OECD “Commentaries on the Articles of the Model Tax Convention” Annex: Sample Mutual Agreement on Arbitration, art 15.

¹⁷⁷ OECD “Commentaries on the Articles of the Model Tax Convention” Annex: Sample Mutual Agreement on Arbitration, art 15.

¹⁷⁸ Gary Born *International Arbitration: Law and Practice* (Kluwer Law International, The Netherlands, 2012) at 365; Campbell McLachlan, Laurence Shore and Matthew Weiniger *International Arbitration: Substantive Principles* (Oxford University Press, Oxford, 2007) at [7.99]; and Rolf Schutze “The Precedential Effect of Arbitration Decisions” (1994) 11(3) *Journal of International Arbitration* 69.

¹⁷⁹ Double Tax Agreements (Japan) Order 2013, sch 1 art 27 and sch 2 cl 16(b)(iv).

confidentiality agreements.¹⁸⁰ This is in stark contrast to domestic court judgments concerning tax liability which are published.

Overall, the MDTC incorporates a much more confidential approach to the publication of awards than is traditionally considered appropriate in inter-state arbitration. New Zealand has adopted the position, in relation to confidentiality, of the subject matter (tax) and not the forum (inter-state arbitration). At a fundamental level this is understandable as “total confidentiality of assessments and of negotiations between individuals and the revenue is a vital elements in the working of the system”.¹⁸¹ However, an uncompromising approach to confidentiality ignores the forum of the dispute and as will be discussed in Part VII may hamper the development of an effective dispute settlement regime.

6 *Barriers to arbitration*

The arbitration provision provides that unresolved issues may not “be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State”.¹⁸² If the arbitration is a true inter-state arbitration, it is axiomatic that the decisions of domestic courts would not bind the international tribunal.¹⁸³ It would be free to decide the case according to international law and its own interpretation of the DTA even if a domestic court has rendered a decision. The OECD however, is not concerned with whether a domestic court would bind or impact an international tribunal, it is concerned with whether or not the award of that tribunal could be implemented.

The OECD is concerned that an arbitral award may be rendered nugatory as competent authorities are not able to implement awards which are contrary to the decision of a domestic court or tribunal. Take the simplified example of the New Zealand tax resident who travels to the US to produce a record album and is not taxed in accordance with the relevant DTA. The taxpayer proceeds to the New Zealand domestic courts to enforce the provisions of the DTA which are incorporated domestically. The courts judge the payment as royalties and not income for services provided in the music industry, and therefore under

¹⁸⁰ Double Tax Agreements (Japan) Order 2013, sch 2 cl 16(b)(iv).

¹⁸¹ *IRC v National Federation of Self-Employed and Small Businesses Ltd* [1982] AC 617 at 633 per Wilberforce LJ.

¹⁸² OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(5).

¹⁸³ International Law Commission *Draft Articles on Responsibility of States for Internationally Wrongful Acts*, 2001 [2001] 2 (2) YB ILC 26 art 3; and McLachlan, Shore and Weiniger, above n 178, at [4.13].

the provisions of the DTA it is taxable at up to 5 per cent in the US and at the full rate in New Zealand. The taxpayer may object however, as classification as royalties results in higher taxes. The taxpayer then petitions the competent authority in New Zealand requesting MAP between the two states and after two years of the issue not being resolved, arbitration. If the arbitral tribunal decides that the payment is income for services provided in the music industry and not royalties, New Zealand must tax the income as income for services provided to the music industry. If the New Zealand Inland Revenue Department (IRD) taxes the \$10,000 as income for services provided however, they are acting unlawfully as according to the prior court judgment the IRD must tax this as royalties. However, if New Zealand chooses not to exercise its right to tax the income, as DTAs create a permissive not prescriptive taxing rights, the taxpayer pays no tax at all, as the US has no right to tax the income for services provided to the music industry, and receives a windfall.

These conflicting decisions may result in taxation not in accordance with the DTA or a windfall for the taxpayer. It is important to note however, that the competence of the arbitral tribunal is not affected, rather pursuing domestic court remedies constitutes a waiver of arbitration by the taxpayer.

For this reason states will often require the suspension of domestic remedies before pursuing MAP and arbitration.¹⁸⁴ If a taxpayer does exhaust domestic remedies in one state and this does not result in a satisfactory decision the taxpayer is free to pursue domestic remedies in the other state. This may be through the courts or unilateral action from the competent authority.

7 No direct taxpayer involvement

The arbitration procedure is not separate from but rather an extension of the MAP process. As such, the taxpayer has the same rights and responsibilities in arbitration as they do in MAP—no right to be heard and the obligation to provide the information sought by the competent authorities.¹⁸⁵ Although the taxpayer initiates the arbitration process by request,¹⁸⁶ the taxpayer is not a party to the arbitration; it is inherently an inter-state arbitration.¹⁸⁷ This is similar to other dispute resolution regimes where individuals are

¹⁸⁴ OECD “Commentaries on the Articles of the Model Tax Convention” article 25 at [76a].

¹⁸⁵ See generally Rosenbloom, above n 153.

¹⁸⁶ OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(5).

¹⁸⁷ Fuller and Bassett, above n 152, at 16.

adversely affected but it is states who take claims. The World Trade Organisation (WTO) for example, includes a dispute resolution system in which states bring claims when it is an individual who has suffered a loss.¹⁸⁸ The individual has no right to bring a challenge to a state's decision.¹⁸⁹

While the OECD has indicated that the states could allow taxpayers the right to be involved in the arbitration, it is entirely at the option of the states.¹⁹⁰ These details are finalised in the arbitration protocols which the two states agree. These protocols cover things such as the establishment of the tribunal, who bears the costs of the arbitration proceedings and the workings of the arbitral tribunal, including the rights of taxpayers.

As mentioned about, the IRD has refused to release the arbitration protocols to the public. This is despite the OECD recommending that they be made public to ensure confidence in the process.¹⁹¹ While the agreement with Japan does have a publically available arbitration protocol in sch 2,¹⁹² this is minimal and does not cover all aspects and makes no reference to the taxpayer or their rights. Therefore, it is entirely possible that there is no protection afforded to the taxpayer at all. This may be a severe oversight as the less involvement a taxpayer has in the process the more likely it is the taxpayer will refuse the award.¹⁹³

8 Taxpayer's refusal of the arbitral award

If a taxpayer chooses to proceed to arbitration, and an unsatisfactory award is delivered, the taxpayer may refuse the award and engage domestic remedies.¹⁹⁴ This severely limits the effectiveness of arbitration which is designed to facilitate an agreement between the states.¹⁹⁵ The OECD has defended this position however, by commenting that this fits within the principle of the arbitration provision. The OECD states that:¹⁹⁶

¹⁸⁸ Marrakesh Agreement establishing the World Trade Organization 1867 UNTS 3 (opened for signature 15 April 1994, entered into force 1 January 1995) annex 2 art 1.

¹⁸⁹ Park, above n 66, at 848.

¹⁹⁰ OECD "Commentaries on the Articles of the Model Tax Convention" Annex: Sample Mutual Agreement on Arbitration, art 11.

¹⁹¹ OECD "Commentaries on the Articles of the Model Tax Convention" article 25 at [85].

¹⁹² Double Tax Agreements (Japan) Order 2013, sch 2.

¹⁹³ Nowland, above n 165, at 191.

¹⁹⁴ OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(5) and OECD "Commentaries on the Articles of the Model Tax Convention" article 25 at [77].

¹⁹⁵ Burch, Nottage and Williams, above n 4, at 1041.

¹⁹⁶ OECD "Commentaries on the Articles of the Model Tax Convention" article 25 at [78].

the purpose of [arbitration] is to allow the competent authorities to reach a conclusion on the unresolved issues that prevent an agreement from being reached. When that agreement is achieved [through] the aid of arbitration, the essential character of the mutual agreement remains the same.

The OECD remains firm in its position that arbitration is not designed to resolve the issue of taxation that is not in accordance with the DTA, rather it is designed to assist the competent authorities in that resolution. It is suggested that this is an unsatisfactory state of affairs. The award “must bind taxpayer and fiscal authorities alike”.¹⁹⁷ To do otherwise would overlook the purpose of introducing an arbitration provision and relegate arbitration to nothing more than a fact finding mission and “foreplay to future litigation”.¹⁹⁸

B Is This an Effective Arbitration Procedure?

One of the most distinct advantages that was to accompany the introduction of arbitration was a definite resolution to instances of taxation not in accordance with the DTA.¹⁹⁹ The need for change was evident; prior to the introduction of arbitration there were instances of some MAP cases extending beyond 10 years without a resolution.²⁰⁰ The current arbitration provision is intended to act as a ‘stick’, encouraging the two states to reach a mutually agreeable decision.²⁰¹ It attempts to do this in two ways.

The first is that a third party, divorced of personal interest in the matter, will purportedly decide the tax rights of a state if a case goes to arbitration. States are attuned to the supposed encroachment onto sovereignty and will be wary of divesting themselves of the power to tax.²⁰² They may be more likely to negotiate a settlement than subject the claim to what some perceive as a fox guarding the chicken coop.²⁰³ The validity of this objection

¹⁹⁷ Park, above n 66, at 805; and Nowland, above n 165, at 191.

¹⁹⁸ Park, above n 66, at 805.

¹⁹⁹ Campos, above n 91, at 372; and Dalton, above n 85, at 16.

²⁰⁰ Campos, above n 91, at 372; and Gustaf Lindencrona and Nils Mattsson “Arbitration in Taxation: An Introduction” (2014) 45 *Intertax* 161.

²⁰¹ J G Merrills *International Dispute Settlement* (5th ed, Cambridge University Press, Cambridge, 2011) at 112; and Nowland, above n 165, at 191.

²⁰² Campos, above n 91, at 371 and 373; Rosenbloom, above n 153; Lindencrona, above n 30, at 266; and Natalia Quinones Cruz “International Tax Arbitration and the Sovereignty Objection: The South American Perspective” (2008) *Tax Notes International* 533 at 534.

²⁰³ Park, above n 66, at 855.

however, also depends on one's conception of sovereignty. The arbitration provision in the DTA may also be seen as an exercise of sovereignty, not an encroachment upon it.

The second way arbitration can work as a stick is because of the extra time and costs that are incurred with arbitration proceedings. The costs, although less than a typical tax trial, increase with the initiation of arbitration. Because the costs of arbitration fall squarely on the contracting states, not the taxpayer, this may encourage the competent authorities to resolve the dispute sooner.²⁰⁴

Whether arbitration has actually worked as a stick is arguable. As noted above, only "unresolved issues" are submitted to arbitration, which the competent authorities can control.²⁰⁵ Furthermore, the taxpayer can refuse any arbitral award, and the arbitration provision and protocol may be manipulated by the contracting states, diluting its effectiveness. With an ineffective procedure the question also arises as to whether or not this process is truly arbitration.

VI Is it Really Arbitration?

There is no one definition of arbitration.²⁰⁶ It has been described as: a private device for dispute settlement,²⁰⁷ a judicial determination outside of courts, and even a "social jurisdiction".²⁰⁸ The first true definition of inter-state arbitration may have come from the 1899 Hague Convention which described arbitration as "the settlement of differences between States by judges of their own choice, and on the basis of respect for law".²⁰⁹ Domestic legislation rarely defines arbitration but rather sets out the principles or purposes of arbitration.²¹⁰ In essence, while consensus as to the definition of arbitration may be unattainable there is a well-recognised irreducible core which each process must contain in

²⁰⁴ OECD "Commentaries on the Articles of the Model Tax Convention" Annex: Sample Mutual Agreement on Arbitration, art 13.

²⁰⁵ OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(5).

²⁰⁶ Lew, Mistelis and Kroll, above n 146, at 3.

²⁰⁷ Rene David *Arbitration in International Trade* (Kluwer Law International, The Netherlands, 1985) at 5.

²⁰⁸ Jerzy Jakubowski "Reflections on the Philosophy of International Commercial Arbitration and Conciliation" in Jan Schultz and Albert Jan Van Den Berg (eds) *The Art of Arbitration* (Kluwer Law and Taxation Publishers, The Netherlands, 1982) 175 at 178.

²⁰⁹ Convention for the Pacific Settlement of International Disputes (July 1899), art 16.

²¹⁰ See Arbitration Act 1996, sch 1 and Arbitration Act 1996 (UK), s 1.

order to secure the title of arbitration.²¹¹ In this part of the paper I will reflect on these irreducible elements and analyse whether the MDTC arbitration process can truly carry the label of arbitration. This analysis will provide the basis for the recommendations that follow in the next part of the paper.

A Binding Arbitration

The first element that is essential to all arbitrations is that they are binding on the parties.²¹² After all the object of progressing to arbitration is to end the dispute.²¹³ Advisory opinions are not within the ambit of arbitration and are better served through other alternative dispute resolution mechanisms. Arbitration is a binding dispute resolution tool for a particular case. It is not designed to set binding precedent for future cases, or set out a recommended course of conduct for future action by the parties. While some limited precedential value may ultimately be ascribed to a body of unanimous arbitral awards that is not the purpose of arbitration. Ultimately, it is to facilitate a judicial settlement of the case presented to the arbitral tribunal.

The taxpayer has the ability to decline the arbitral award and resort to domestic remedies. It is unclear whether the arbitral award is binding on the states in any event. This is because any arbitral award designed to assist the competent authorities in the resolution of particular and distinct issues within the case as a whole. The arbitral award must be incorporated into a MAP agreement to which the states then agree. Though unlikely, it is permissible, in theory, for the contracting states to disregard the arbitral award so long as they can agree to a position, then incorporated through a MAP agreement, to taxation in accordance with the DTA.

This is a similar format to the General Agreement on Tariff and Trade dispute settlement regime which required both states to accept the arbitral award before it would be binding.²¹⁴ This was one of the main reasons for the WTO revising its dispute resolution regime

²¹¹ Born, above n 178, at 4; Lew, Mistelis and Kroll, above n 146, at 3; Jakubowski, above n 208, at 177; and Law Commission, above n 115, at 59.

²¹² Born, above n 178, at 5; J G Merrills *International Dispute Settlement* (5th ed, Cambridge University Press, 2011) at 105; Convention for the Pacific Settlement of International Disputes (July 1899), art 16; Pacific Settlement of International Disputes (October 1907), art 81; and Kenneth Carlston *The Process of International Arbitration* (Columbia University Press, New York, 1946) at 259.

²¹³ Merrills, above n 212, at 105; and Law Commission, above n 211, at 61.

²¹⁴ Bashar Malkawi "Arbitration and the World Trade Organisation: The Forgotten Provisions of Article 25 of the Dispute Settlement Understanding" (2007) 24 JOIA 173 at 174.

because this process was ineffectual as “the losing party in a dispute could block the adoption of a panel ruling”.²¹⁵

The WTO contains a binding dispute settlement where a Panel is commissioned by a larger Dispute Settlement Body (DSB) to settle trade disputes. The decision of the Panel, which hears submissions and evidence, is binding on the parties unless the DSB decides unanimously to reject it.²¹⁶ This is much more in line with the fundamental basis of arbitration as being a *binding* dispute settlement process. The parties to the dispute do not have the ability to reject the findings of the Panel or the DSB. The individual is severely disadvantaged however, as they cannot rely on the decision of the Panel or DSB.²¹⁷ The state breaching its obligations must independently remove the illegal tariff or face retaliation from other states.

Arbitration generally does not include a power to take into account new facts after an award has been issued, nor is there a general right of appeal.²¹⁸ A request for the annulment of an award however, will be permissible when “the tribunal has transgressed a basic rule of judicial procedure” which leads to the award losing “its judicial character”.²¹⁹

The current model of arbitration in the MDTC does not facilitate a binding award. Rather the current arbitration model is akin to a fact finding process or an advisory opinion. While the fact finding process is invaluable at international law, this is not the role of arbitration. The role of fact finding is traditionally left to Commissions of Inquiry.²²⁰ Commissions of Inquiry are heavily used domestically and by international institutions, in particular the UN. While there is no doubt fact finding in arbitration, as each party will present their version of events and the tribunal will be required to decide, this is done in the context of a larger dispute resolution process.²²¹ If the parties want to ensure that they have the correct facts to determine the tax rights and obligations arbitration is an inefficient and unusual means to employ. Both international and domestic law have a robust process for fact finding and to substitute this process for arbitration is not effective.

²¹⁵ Malkawi, above n 214, at 174.

²¹⁶ Malkawi, above n 214, at 178.

²¹⁷ Park, above n 66, at 849.

²¹⁸ Merrills, above n 212, at 107.

²¹⁹ Merrills, above n 212, at 110; and Carlston, above n 212, at 39.

²²⁰ Pacific Settlement of International Disputes (October 1907), arts 9–36; and Nii Lante Wallace-Bruce *The Settlement of International Disputes: The Contribution of Australia and New Zealand* (Kluwer Law International, The Netherlands, 1998) at 41.

²²¹ Wallace-Bruce, above n 220, at 41.

B Arbitration as an Alternative to National Courts

An allied element of binding arbitration is that arbitration is to be an alternative to national courts.²²² Arbitration is designed to facilitate the settlement of a dispute outside of the boundaries of domestic court litigation. The rationale for this is that arbitration can provide a more flexible process which can be adapted to the dispute at hand.²²³ Different disputes may be better catered to with different procedural rules.²²⁴

As discussed above,²²⁵ the OECD currently envisages a restriction on the availability of MAP and arbitration when a decision has been reached by domestic courts.²²⁶ This does not apply in the inverse however. If a taxpayer petitions for MAP and a decision of an arbitral tribunal has been rendered, which the taxpayer refuses to accept, the taxpayer is free to pursue domestic remedies. This undermines the effectiveness of arbitration as an alternative dispute resolution mechanism. In essence it creates a hierarchy of tribunals. Each step is effectively an appeal from the last, with the domestic courts being the final decision-maker.

Arbitration in the MDTC does not act as an effective alternative to national courts. Rather it relegates itself to a preliminary or advisory opinion which the taxpayer could then override through the domestic courts. It does not meet the fundamental tenets of arbitration to resolve matters quickly, effectively and with finality.²²⁷

C Party Autonomy

Arbitration is principally a process in which the parties have complete control over the process.²²⁸ Arbitration requires the parties to “set up the machinery” through which the tribunal will resolve the dispute.²²⁹ It is up to the parties to select the arbitrators,²³⁰ define

²²² Lew, Mistelis and Kroll, above n 146, at 3.

²²³ Born, above n 115, at 6; and Carlston, above n 212, at 260.

²²⁴ Carlston, above n 212, at 6.

²²⁵ See discussion above “Barriers to Arbitration” at page 31.

²²⁶ OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(5).

²²⁷ See generally Merrills, above n 212; and Carlston, above n 212.

²²⁸ Redfern and others, above n 147, at 265.

²²⁹ Merrills, above n 212, at 88; and Lew, Mistelis and Kroll, above n 146, at 3.

²³⁰ Merrills, above n 212, at 92.

the issues to be resolved by the tribunal,²³¹ and to set down the process the tribunal will follow.²³² This autonomy is recognised by the MDTC, although the OECD has issued guidance as to the appropriate process for the arbitration, it remains non-binding and up to the parties to conclude the final protocol.

Party autonomy has been described as the “ultimate power” in arbitration proceedings.²³³ This power is recognised by most domestic jurisdictions which will only impose restrictions or provisions when the arbitral provision is silent.²³⁴ Party autonomy is not fully present in the OECD model of arbitration. The taxpayer is not a party to the arbitration yet has a significant effect on the parties.

The taxpayer can refuse the award and render it nugatory.²³⁵ This is contradictory to the fundamental basis that the parties to arbitration have complete autonomy, it is designed to be a private mechanisms for dispute settlement but a third party has the ultimate decision as to whether the award is effectual.

D Conclusion

Three fundamental features of arbitration can be derived from literature and arbitral practice: the award is binding, arbitration is an alternative to national courts and the parties to the arbitration have complete autonomy. The OECD model of arbitration fails however, on all three accounts.

VII Where to from here?

The current incarnation of arbitration in the MDTC may not represent the irreducible elements of arbitration but that does not mean it is a complete failure. The introduction of arbitration into the MDTC has been a significant step forward in creating a more stable and informative regime of international tax law. There remain however, significant areas for improvement. This is not a criticism of the OECD’s attempt; in any nascent proposal there will be room for improvement. What is needed, to provide an adequate arbitration provision, is a *sui generis* arbitral regime specific to the intricacies of international tax issues. An arbitration system which provides the core of arbitral practice but is also refined

²³¹ Merrills, above n 212, at 95.

²³² Merrills, above n 212, at 99.

²³³ Lew, Mistelis and Kroll, above n 146, at 5.

²³⁴ Lew, Mistelis and Kroll, above n 146, at 3.

²³⁵ OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(5).

to deal with the intricacies of competing sovereign claims and the desire to facilitate economic development. In this part of the paper I will attempt to define the improvements that can be made to the MDTC.

A Institutional Arbitration

The first of the recommendations is the provision of a specialised tax arbitration institution. An arbitral institution is a focussed body which can facilitate arbitration with a particular set of procedural rules, location and professional staff particular to the subject matter of the dispute.²³⁶ It has been long recognised that institutional arbitration can provide many benefits over ad hoc arbitration tribunals which can be unpredictable.²³⁷ Much like the permanently established arbitration courts that exists today—for the likes of sport,²³⁸ maritime law,²³⁹ the grain and feed trade,²⁴⁰ and the metal industry²⁴¹—tax arbitration is well positioned to form an institutional body.

As was mentioned earlier, most DTAs are based on the MDTC,²⁴² therefore most disputes will be centred on similar, if not identical provision. The parties can be confident that the arbitrators, and the institution that is selected to hear the dispute, have a full understanding of the intricacies of the standard form DTA meaning disputes can be rectified in an orderly and timely manner.²⁴³ This may further increase the legitimacy of the arbitral awards and as a result they may be more persuasive than ad hoc arbitral awards. Institutional arbitration does not require the formation of an entirely new and innovative arbitral organisation. Rather the institutional tax arbitration can be a tailored arbitration under the auspices of an existing body like the PCA.

Issues such as *compétence-compétence* may also arise with the proliferation of arbitration in DTAs. States have shown a weariness to the introduction of arbitration in tax. An

²³⁶ Born, above n 115, at 27.

²³⁷ Born, above n 178, at 66; and V S Deshpande “How International Arbitration can always Prevail over Litigation” (1987) 4 *Journal of International Arbitration* 9 at 12.

²³⁸ The Court of Arbitration for Sport (*Tribunal arbitral du sport*).

²³⁹ German Maritime Arbitration Association; Maritime Arbitration Association of the United States; and Tokyo Maritime Arbitration Association.

²⁴⁰ Grain and Feed Trade Association (GAFTA) Arbitration.

²⁴¹ London Metal Exchange (LME) Arbitration.

²⁴² Christians, above n 6 at 15; Rosenbloom and others, above n 6, at 61; and Thuronyi, above n 6, at 1641.

²⁴³ Mustill, above n 116, at 50.

institutional tribunal with experienced arbitrators may be better suited to decide on these issues compared to ad hoc arbitrators.²⁴⁴ The expansion of DTAs has also meant that less developed countries are more frequently becoming engaged in these types of treaties. As a result the dispute resolution processes may be slowed because less developed nations do not have the same experience as their more developed counterparts.

Institutionalised arbitration can remedy this experience imbalance.²⁴⁵ Institutional arbitration also allows for the mechanics of arbitration to be settled in advance rather than through negotiation, which is currently the case. This can significantly reduce the cost of arbitration. The selection of arbitrators, their fees and support staff will also be more easily managed with institutional arbitration compared to ad hoc arbitration.²⁴⁶ The risk of procedural breakdown is reduced considerably with an experienced staff and arbitrators available to guide the parties through arbitration.²⁴⁷ This extra support is vital when one of the issues of prolonging the settlement of disputes is the parties themselves. This is one of the reasons why the vast majority of international arbitration practitioners prefer institutional arbitration.²⁴⁸

Over time these institutional arbitration awards can guide and inform MAP negotiations, educating taxpayers and competent authorities alike of the potential resolution.²⁴⁹ This is crucial to developing a uniform international tax law, rather than a system which is subject to horse trading and siloed decisions of the individual and ad hoc arbitrations. This is a significant concern of those advocating for some sort of multilateral treaty for tax matters.²⁵⁰ While not within the scope of this paper it should be noted that an institutionalised arbitration structure, combined with the fact that most bilateral treaties are based on the MDTC, would allow for coherent and more uniform interpretation of treaties—in essence achieving many of the benefits that a multilateral treaty would provide.²⁵¹

²⁴⁴ Born, above n 115, at 66.

²⁴⁵ Schutze, above n 178, at 72; and Mustill, above n 116, at 54.

²⁴⁶ Born, above n 115, at 66.

²⁴⁷ Born, above n 115, at 66.

²⁴⁸ Born, above n 115, at 67.

²⁴⁹ Schutze, above n 178, at 71.

²⁵⁰ See Thuronyi, above n 6, at 1641; and Rosenbloom and others, above n 6, at 57.

²⁵¹ Park, above n 66, at 808.

B Clear Arbitral Process

Currently the OECD provides for the mechanics of the arbitration procedure, such as the appointment of arbitrators to be decided by the states.²⁵² It is understood that New Zealand's competent authority has finalised arbitration protocols with the two states New Zealand has arbitration provisions (Australia and Japan).²⁵³ These agreements remain confidential and requests to view these have been denied. The confidentiality of the arbitral process may significantly reduce the attractiveness of arbitration to taxpayers. Rather than arbitration increasing confidence for taxpayers, the confidentiality has added another layer of uncertainty and doubt.

1 Taxpayer involvement

It is likely that the taxpayer will be excluded from arbitration. The taxpayer is however, a primary stakeholder in the arbitration, so to exclude the taxpayer seems to be unreasonable and defeat the purpose of DTAs generally.²⁵⁴ DTAs were designed to allocate taxing rights so as to avoid double taxation, and facilitate economic growth. In order to best achieve this outcome the taxpayer should be involved.²⁵⁵

It is understood that the IRD and the competent authority will continue to consult with taxpayers during the arbitration process, as they do during MAP. Furthermore, often the position of one competent authority will consistent with the position of the taxpayer. Take the situation initially described; a New Zealand tax resident travels to the US to produce and record music for an album and earns \$10,000 for doing so. The taxpayer might declare this on their New Zealand tax return as income for services provided to the music industry while not declaring it in the US due to the DTA in place between the two states. Therefore, the taxpayer's position would be that the \$10,000 payment was income and subject only to New Zealand taxation. This, more likely than not, would be the same position that New Zealand would take, in order to retain its tax base. The US however, would claim that it is royalties to secure the 5 per cent tax.

This however, does not entirely mitigate the need for taxpayer involvement. While the approach of the competent authority may, in essence, represent the taxpayer's views it

²⁵² OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(5).

²⁵³ Double Taxation Relief (Australia) Order 2010, schedule one, art 25; and Double Tax Agreements (Japan) Order 2013, schedule one, art 26.

²⁵⁴ Fuller and Bassett, above n 152, at 16.

²⁵⁵ Nowland, above n 165, at 191.

cannot always be guaranteed that that will be the case. In more complex disputes, such as transfer pricing, the views of the taxpayer may not be represented effectively. Furthermore, if the tribunal raises questions about the facts, the competent authorities may not be able to answer them. This may cause undue delays while the information was obtained from the taxpayer, further reducing the attractiveness of arbitration.²⁵⁶ The taxpayer should have the right to be a party to the arbitration.²⁵⁷

2 Restricting the use of baseball arbitration

Not only is it imperative that the arbitral process is clear and set out in advance but the method of arbitration must also be the most conducive to creating certainty and in turn confidence. As explained above, baseball arbitration is a process where each party submits to the arbitral tribunal their last best offer that they would have been willing to accept.²⁵⁸ The tribunal then simply selects one of the offer and notifies the parties of the offer so selected. There is no requirement for a legally robust reasoned decision,²⁵⁹ rather this type of arbitration is based on the idea that each party will rationalise their interpretation of the treaty for fear that the more extreme the interpretation the less likely the arbitrators are to select that offer.²⁶⁰

While baseball arbitration has been effective at getting timely solutions it does nothing to address the larger problem that exists within international tax law—the lack of consensus and open decision-making. What baseball arbitration does is continue to exacerbate the vacuum in which international tax law exists by developing a series of incoherent, irreconcilable, and unreasoned arbitral decisions. It is understood that the New Zealand's competent authority has agreed upon baseball arbitration in its arbitral agreements with Japan and Australia, this is disappointing.

C Publication of Awards

Institutionalised arbitration cannot alone create a coherent body of international tax law for “an arbitration tribunal cannot follow a previously issued arbitration decision without knowing of it”.²⁶¹ Objectors to the publication of arbitral awards adhere to a traditional

²⁵⁶ Fuller and Bassett, above n 152, at 16.

²⁵⁷ See generally Nowland, above n 165.

²⁵⁸ Ault, above n 153, at 149.

²⁵⁹ Fuller and Bassett, above n 152, at 17; and Rosenbloom, above n 153.

²⁶⁰ Lew, Mistelis and Kroll, above n 146, at 13.

²⁶¹ Schutze, above n 178, at 73.

concept of confidentiality in arbitration.²⁶² As discussed above however, it is now a widely recognised concept that when a state is party to the arbitration the right of the public to hold the exercise of public power to account must prevail over the confidentiality of the arbitral proceedings.²⁶³ Furthermore, the OECD has acknowledged, though admittedly in a weak fashion, that they contemplate awards being published, stating “publishing the decisions would lend additional transparency to the process”.²⁶⁴

Publication of the arbitral awards is desirable and would benefit international tax law in three clear ways: a) it would reduce reliance on commentary which tends to be theoretical and expressed in general terms and b) it would create clearer expectations for the taxpayer and c) it would create a more coherent system of decisions.²⁶⁵ The influence of institutional agreement in the area of international tax law has been discussed at length above. While it allows states to compromise and agree to the taxation of international activities, there is a significant reduction in clarity when disputes arise. While individual taxpayers may benefit from negotiated MAP settlements, society as a whole may question whether it too benefits from these settlements.²⁶⁶ Publication of how governments impose tax obligations upon their taxpayers has been characterised as a matter of fairness to taxpayers as a whole.²⁶⁷

The publication of awards would enable a movement away from the disparate solutions to double taxation. Publication of awards may encourage the use of prior arbitral decisions as authority and provide a cohesive international tax regime. The risk of fragmentation and

²⁶² Schutze, above n 178, at 73.

²⁶³ Cremades and Cortes, above n 170, at 30. See also discussion above at “Confidentiality” at page 29.

²⁶⁴ OECD “Commentaries on the Articles of the Model Tax Convention” Annex: Sample Mutual Agreement on Arbitration, art 15.

²⁶⁵ Markham, above n 93, at 68.

²⁶⁶ One need only look to the discussions around Facebook, Starbucks, and other large multinationals paying close to no tax in many jurisdictions—see for example Mark Sweeny “Facebook Pays No UK Corporation Tax for a Second Year” *The Guardian* (online ed, 22 October 2014); Ben Chapman-Smith “Facebook NZ’s \$14k Tax Bill ‘A Rort’ – Labour” *The New Zealand Herald* (online ed, Auckland, 29 November 2012); Simon Bowers “Starbucks Brews Up First UK Profits in 7 Years” *The Guardian* (online ed, 4 February 2015); and Vanessa Barford and Gerry Holt “Google, Amazon, Starbucks: The Rise of ‘Tax Shaming’” *BBC News Magazine* (online ed, 21 May 2013).

²⁶⁷ Christians, above n 1, at 1409; and Leandra Lederman “Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance” (2007) 60 *Stan L Rev* 695 at 710.

varying interpretations of essentially the same DTA would be reduced.²⁶⁸ This idea of loose precedent has already been incorporated into other areas of international arbitration.²⁶⁹

Publication of awards may also result in fewer taxpayer objections and provide clearer guidance to competent authorities. The disputes which are pursued by taxpayers will not all be unique. Often they will not have a unique treaty provision, as majority of DTAs in force are based on a single document.²⁷⁰ The publication of arbitral awards will facilitate greater settlement of disputes during the MAP process.

Each competent authority would be aware of the interpretation of similar DTAs and what arguments a tribunal has previously found persuasive. Some authors have suggested that this precedential value of the arbitral awards is something to be avoided.²⁷¹ This overlooks one of the main drivers for inclusion of arbitration in international tax law, which is to reduce uncertainty. Uncertainty is a significant cost of doing business and in order to reduce this and facilitate economic growth, states need to make outcomes more certain or predictable. Moreover, the effect of having vastly different decisions in different arbitrations would have the effect of creating distinct silos and legal regimes. The tax laws which apply to individuals would differ depending on their circumstances and the success or not of the competent authority pitching an acceptable offer in MAP negotiations. This is an incoherent way of deciding tax policy, which not only undermine economic confidence but also the rule of law.²⁷²

D Binding Arbitration

The arbitral award should be binding on the taxpayer and competent authorities alike.²⁷³ This proposition requires two principles to be recognised. The first is not limiting the scope of arbitration to fact only. The second is a modified concept of *res judicata* or waiver.

²⁶⁸ Jack Samra and Pedro Martinez-Fraga “The Role of Precedent in Defining Res Judicata in Investor-State Arbitration” (2012) 32 *NwJIntlLBus* 419 at 421.

²⁶⁹ McLachlan, Shore and Weiniger, above n 178, at [7.99].

²⁷⁰ Christians, above n 6, at 15; Rosenbloom and others, above n 6, at 61; and Thuronyi, above n 6, at 1641.

²⁷¹ Rosenbloom, above n 153.

²⁷² A V Dicey *Introduction to the Study of the Law of The Constitution* (10th ed, MacMillan Education, Basingstoke, 1959) at 188; and David Feldman *English Public Law* (Oxford University Press, Oxford, 2004) at 30.

²⁷³ Nowland, above n 165, at 193.

1 *Scope of the arbitration*

The scope of the arbitration must be wide enough to encompass all unresolved matters and not restricted to issues of fact. As explained above, restricting the arbitration to issues of fact creates something akin to a commission of inquiry releasing an advisory opinion and not an arbitral tribunal. In order to be most effective the arbitral tribunal's competence should not be limited. While states will ultimately have the final say on what the arbitral tribunal is required to decide, encouraging states to widen the scope of arbitration may help to create a more coherent practice and interpretation of DTAs internationally.

2 *Res judicata*

The MDTC requires the taxpayer to select a course of action in the first instance; whether they would like to pursue the MAP process and arbitration or domestic legal remedies to resolve the double taxation. If a taxpayer elects to resolve the issue of double taxation in the domestic courts, the taxpayer cannot then have recourse to MAP or arbitration. This does not apply to the inverse situation however. If a taxpayer chooses to proceed to MAP and arbitration, and an unpalatable award is delivered, the taxpayer may refuse the award and engage domestic remedies. It is suggested that this is unsatisfactory. A taxpayer should not have recourse to domestic courts once there has been an arbitral decision in their particular case. In essence the doctrine of *res judicata* should apply with respect to the arbitral decision and bind both the competent authorities and the taxpayer alike.

The doctrine of *res judicata* is widely accepted as a general principle of international law.²⁷⁴ While there may be slight variations to the general expression of the doctrine,²⁷⁵ the essence of *res judicata* is that "once adjudicated, a claim cannot be raised again".²⁷⁶ The *res judicata* triple identity test prevents re-litigation of claims. The three factors are a) the same parties, b) the same subject matter, and c) the same cause.²⁷⁷ *Res judicata* has both positive and negative effects.²⁷⁸ The positive effect is that once a decision has been made by a court or a tribunal it becomes final and binding on all parties. The negative effect is that the subject

²⁷⁴ Gary Born, above n 115, at 1047; McLachlan, Shore and Weiniger, above n 178, at [4.13]; Gretta Walters "Fitting a Square Peg into a Round Hole: Do Res Judicata Challenges in International Arbitration Constitute Jurisdictional or Admissibility Problems" (2012) 29 *Journal of International Arbitration* 651 at 652; and Vaughan Lowe "Res Judicata and the Rule of Law in International Arbitration" (1996) 8 *AfrJIntlCompL* 38 at 39.

²⁷⁵ See for example Lowe, above n 274, at 39.

²⁷⁶ Samra and Martinez-Fraga, above n 268, at 421.

²⁷⁷ Lowe, above n 274, at 40; and Samra and Martinez-Fraga, above n 268, at 421.

²⁷⁸ Walters, above n 274, at 652

of the dispute cannot be re-litigated by the same parties in a later forum.²⁷⁹ The principle of res judicata is essential element to produce efficient tax arbitration.²⁸⁰ The award “must bind taxpayer and fiscal authorities alike”.²⁸¹

When applied strictly however, the doctrine may be of no effect in the MDTC. This is because the parties to the dispute are not identical. The parties to arbitration are the two contracting states while the parties to the domestic court action would be the Revenue Department of one state and the taxpayer. Furthermore, the cause of action in arbitration is a breach of the DTA, while the cause of action in domestic proceedings is a breach of the domestic law. For this reasons recourse must be made to other instruments to prevent contradictory decisions from eventuating. International commercial arbitration has developed a similar principle to res judicata which may be helpful in this context: waiver.

3 Waiver

International investment arbitration has developed the concept of waiver to prevent the possibility of contradictory decisions from domestic courts and international arbitrations. Commercial arbitration requires an election at the time of the initial proceedings, whether the investor will pursue domestic or international remedies, as a method to limit an investor’s claims to a single forum.²⁸² Applied in the context of the MDTC the taxpayer will either select domestic or international remedies at two points. When the case is initially brought by the taxpayer to the competent authority, and after two years of MAP negotiations.²⁸³

This still requires the cause and subject matter to be the same. Taxation not in accordance with the DTA, whether on the international or domestic plane. This waiver or election is similar to res judicata in that it restricts the taxpayer to *either* arbitration or domestic remedies. Without waiver tax arbitration cannot be seen as anything more than an extended “foreplay to future litigation”.²⁸⁴

²⁷⁹ Walters, above n 274, at 653.

²⁸⁰ Park, above n 66, at 805.

²⁸¹ Park, above n 66, at 805.

²⁸² McLachlan, Shore and Weiniger, above n 178, at [4.84].

²⁸³ See Appendix Two.

²⁸⁴ Park, above n 66, at 805.

4 Deference

Concerns have been raised by some tax professionals about taxpayers not having recourse to domestic courts after arbitration when the DTA is a domestic tax obligation. These concerns can be mitigated to a large degree by reflecting on the approach that the courts will take to the arbitral awards in any event.

Domestic courts are likely to show a significant amount of deference to a decision of a properly constituted and reasoned arbitral award.²⁸⁵ This deference should not be seen as a refusal for an independent decision on the issue, rather it is a recognition of the process which has resulted in the award. An arbitration tribunal will often be a specialised tribunal, constituted by the parties themselves with the arbitrators selected because of their expertise. A court would be right to take into account this expert opinion when delivering its judgment and would be unlikely to depart from it.

The possibility of greater deference is further increased if the other proposals I have suggested are accepted, namely taxpayer involvement. If the taxpayer has the right to be heard and present their case to the arbitral tribunal, a court is likely to show further deference to the tribunal. The courts are likely to be unwilling to allow a taxpayer to continue to litigate until they receive a decision that is in their favour. The courts have shown a great willingness in the past to uphold the spirit of DTAs including assessing what view a foreign competent authority would take when making its own judgment.²⁸⁶ Therefore recourse to domestic courts may not achieve anything other than drawing out the proceedings. It is suggested that waiver is not only essential to create an effective arbitration scheme but it is *desirable*.

²⁸⁵ See generally William W Park “Determining Arbitral Jurisdiction: Allocation of Tasks between Courts and Arbitrators” (1997) 8 Am Rev Intl Arb 133; Stephan W Schill “Deference in Investment Treaty Arbitration: Reconceptualizing the Standard of Review through Comparative Public Law” (paper presented to the Third Biennial Global Conference, Singapore, July 2012); and Anthea Roberts and Christina Trahanas “Judicial Review of Investment Treaty Awards: BG Group v Argentina” (2014) AJIL 108 750.

²⁸⁶ See for example *Commissioner of Inland Revenue v JFP Energy Inc* [1990] 3 NZLR 536 at 542; *Knights of Columbus v R* 2008 TCC 307 at [3]; and *American Income Life Insurance Company v Canada* 2008 TCC 306 at [83].

E Annulment Mechanism

The finality of awards is an important element of arbitration and one that helps attract parties away from litigation.²⁸⁷ However, it is recognised that without some control mechanisms there is potential for “wild card” awards to undermine the arbitration process.²⁸⁸ The MDTC does not expressly provide an annulment procedure. Though one could interpret the taxpayer rejection as a primitive form of annulment mechanism.

The ultimate goal of an annulment mechanism is not to re-adjudicate the award but rather to correct procedurally defunct awards.²⁸⁹ It should be noted that there is a distinct difference between appeal and annulment. While appeal may deal with substantive correctness of the award, annulment is concerned only with procedural legitimacy.²⁹⁰

There are a range of annulment mechanisms used in international arbitration. In international commercial arbitration there are three central and competing regimes: a) appeals to the judicial authority of the state asked to enforce the award, b) a self-contained system that allows for an extraordinary challenge procedure, and c) review at the seat of the arbitration. Inter-state arbitration is traditionally limited to review by the International Court of Justice (ICJ) or a special review panel constituted by the PCA. This part of the paper will assess the validity of three annulment mechanisms which may be included in the MDTC.

1 Enforcement state assessment

One of the most widely accepted annulment procedures is that contained in the New York Convention.²⁹¹ The New York Convention allows the judicial authorities of enforcement states to inquire into the award’s validity. While traditionally used for commercial arbitration as it is limited to commercial matters, some commentators have suggested that the Convention may apply to inter-state arbitration where there are “commercial or financial disputes”—which could include DTAs.²⁹² Regardless of whether the Convention is applicable the substance of the annulment procedure could be incorporated into the

²⁸⁷ Born, above n 115, at 1047; and Christoph Schreuer “Form ICSID Annulment to Appeal: Half Way Down the Slippery Slope” (2011) 10 Law Prac Intl Cts Tribunals 211.

²⁸⁸ Park, above n 66, at 805; and Schreuer, above n 287, at 211.

²⁸⁹ Park, above n 66, at 805.

²⁹⁰ Schreuer, above n 287, at 212.

²⁹¹ Convention on the Recognition and Enforcement of Foreign Arbitral Awards 330 UNTS 38 (opened for signature 10 June 1958, entered into force 07 June 1959).

²⁹² Born, above n 178, at 42; and Park, above n 66, at 841.

MDTC. Awards can be annulled on the basis that the awards were procedurally flawed or against public policy.²⁹³ An assessment of substantive correctness of the award is prohibited.

The nature of taxation disputes could lead to an overuse of the public interest annulment procedure. The tax revenue of a state is inherently connected with public policy. There is no doubt that awards impacting tax policy and revenue are “likely to implicate and possibly violate one or more of the numerous expressions of public policy embodied in the growing myriad of statutes, regulations, and common law doctrines”.²⁹⁴ The ambiguous concept of public interest may invite increased intervention.²⁹⁵

Furthermore, when a review of an award is conducted by domestic courts it brings into stark focus the underlying tension between domestic courts and international tribunals.²⁹⁶ Domestic courts must be careful not to exercise excessive control over the arbitral proceedings and risk the advantages of arbitration being undermined.²⁹⁷ This is especially so in the context of inter-state arbitration as the arbitration should be completely “delocalised” from domestic judicial systems to protect its integrity.²⁹⁸ Therefore, this type of annulment mechanism may not be desirable for inclusion in the MDTC.

2 *Review by a third party*

Annulment procedures may also be facilitated by the ICJ or the PCA.²⁹⁹ The ICJ will likely not hear an application for annulment from a taxpayer however, as ICJ jurisdiction only extends to cases brought by states.³⁰⁰ The PCA does however, have a procedure where only one party is a state and could facilitate a challenge to the arbitration.³⁰¹ This is premised on the proposition that the taxpayer would be a party to the arbitration and could therefore

²⁹³ Convention on the Recognition and Enforcement of Foreign Arbitral Awards 330 UNTS 38 (opened for signature 10 June 1958, entered into force 07 June 1959); and Park, above n 66, at 843.

²⁹⁴ David Dlanstein “A Hail Mary Pass: Public Policy Review of Arbitration Awards” (2001) 16 Ohio St J Disp Resol 297 at 298.

²⁹⁵ Born, above n 178, at 325; and Nowland, above n 165, at 202.

²⁹⁶ Law Commission, above n 115, at 65.

²⁹⁷ Law Commission, above n 115, at 67.

²⁹⁸ Law Commission, above n 115, at 67.

²⁹⁹ Park, above n 66, at 849.

³⁰⁰ Statute of the International Court of Justice, arts 34–35.

³⁰¹ See for example *The Government of Sudan v The Sudan People's Liberation Movement/Army (Final Award)* PCA 22 July 2009.

request annulment. If the taxpayer is not a party, then the taxpayer would rely on a state “sponsor” for the request.³⁰²

3 Self-contained extraordinary challenge procedure

The International Centre for the Settlement of Investment Disputes (ICSID) provides for an internal, self-contained extraordinary challenge to awards.³⁰³ Some commentators have indicated that an ICSID approach is not practical in tax arbitration because of the insufficient resources and will of states to set up a second arbitral tribunal.³⁰⁴ In the absence of a second arbitral tribunal such challenges are likely to be facilitated by domestic courts as described above. Concerns about cost and state will are mitigated to a large extent by the introduction of an institutional body. The institution would be able to facilitate the annulment body and may be housed within the OECD, the PCA, or a separate standalone body to consider challenges. This option may be the preferred option to avoid the concerns identified above with enforcement state and third party annulment.

Facilitation of an annulment of an award is a necessary requirement to encourage state and taxpayers to recognise the final and binding nature of the award. The annulment procedure may assist in mitigating the sovereignty concerns of states as “wild card” awards can be corrected. The taxpayer may also rest assured that any extraordinary failings of the tribunal can be mitigated and their tax obligations corrected. It is anticipated however, that annulment will continue to be “an unusual result”.³⁰⁵

F The New Arbitral Procedure

It is helpful to review the procedure that has been proposed in this paper.³⁰⁶ Once the taxpayer is aware that they have been subject to taxation not in accordance with the DTA they have an option to either commence domestic proceedings or engage in the MAP process. In reality, the taxpayer will often do both, however, they will suspend the domestic

³⁰² Park, above n 66, at 849.

³⁰³ Convention for the Pacific Settlement of International Disputes (18 October 1907) art 83; International Centre for Settlement of Investment Disputes “Convention on the Settlement of Investment Disputes between States and the Nationals of Other States” art 52; and Park, above n 66, at 847.

³⁰⁴ Park, above n 66, at 806.

³⁰⁵ Born, above n 178, at 303.

³⁰⁶ For further clarification recourse may be had to Appendix Two.

remedies while the MAP process is ongoing. If domestic remedies are not suspended and a judgment is given, MAP will no longer be available.

If the MAP process is pursued this will continue for two years. After two years of MAP negotiations the taxpayer will face another election. The taxpayer has the choice to *either* proceed to arbitration or re-engage domestic court proceedings. This selection will waive any entitlement that the taxpayer has to alternative remedies. For instance, if the taxpayer selects to proceed to arbitration they will not have recourse to domestic litigation and vice versa. Because of this waiver, arbitration will remain within the sole discretion of the taxpayer. The competent authorities should not be able to bind the taxpayer to arbitration and waive their entitlement to domestic remedies.

VIII Conclusion

Every sovereign state has the inherent right to impose taxes in accordance with its own laws.³⁰⁷ Taxation is one of the ways states can benefit from the effects of continued economic development. The collision between economic activity and national interest however, can impose the burden of double taxation upon taxpayers as each state competes to secure a portion of the benefit. As a result of the negative effects caused by double taxation, states began agree on taxing rights.³⁰⁸ For the most part, these agreements are now in the form of DTAs based on the MDTC. They are designed to encourage economic activity within the borders of each state while at the same time prescribing the entitlements of each state to tax revenue. The competing interests of states however, can still raise issues of interpretation and threaten to thwart the purpose of DTAs.

The differences of interpretation and application have increased the spotlight on DTA dispute resolution clauses. The latest move by the OECD has been to include a provision for arbitration.³⁰⁹ While arbitration has long been included in a number of international business and economic treaties,³¹⁰ its inclusion in tax treaties came late. The OECD proposal has fallen short of expectations. While any nascent proposal will be subject to

³⁰⁷ See generally Jean Bodin *Six Books of the Commonwealth* (Balckwell, 1576); Dicey, above n 272; Adam Tomkins *Public Law* (Oxford University Press, Oxford, 2003); Thuronyi, above n 6, at 1646; and Rosenbloom, above n 153.

³⁰⁸ Irish, above n 3, at 132.

³⁰⁹ OECD Model Convention with Respect to Taxes on Income and Capital 2014, art 25(5).

³¹⁰ See for example The Energy Charter Treaty 2008 UNTS 95 (opened for signature 17 December 1994, entered into force 16 April 1998), art 26; and United Nations Convention on the Law of the Sea 1833 UNTS 397 (opened for signature 10 December 1982, entered into force 16 November 1944), art 188.

possible improvements the decision making process in the OECD has diluted the arbitration provision to the extent where it cannot seriously be considered arbitration.

The MDTC model of arbitration does not result in binding decisions. The taxpayer, who is not a party to the proceedings, may decline the award and subject competent authorities to domestic litigation or continued MAP negotiations. Furthermore, the taxpayer, a centrally affected party, has no input. The arbitral procedure is not a true alternative to domestic courts. Arbitration has proven to be an effective dispute resolution mechanism at international law. With the adoption of the recommendations made in this paper the arbitration clause in the MDTC can develop into an effective and efficient regime for resolving tax disputes. A regime that caters for the intricacies of competing sovereign claims while continuing to encourage economic development.

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IX Appendix One

OECD MDTC

ARTICLE 25

MUTUAL AGREEMENT PROCEDURE

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 paragraph 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, 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.
5. Where,

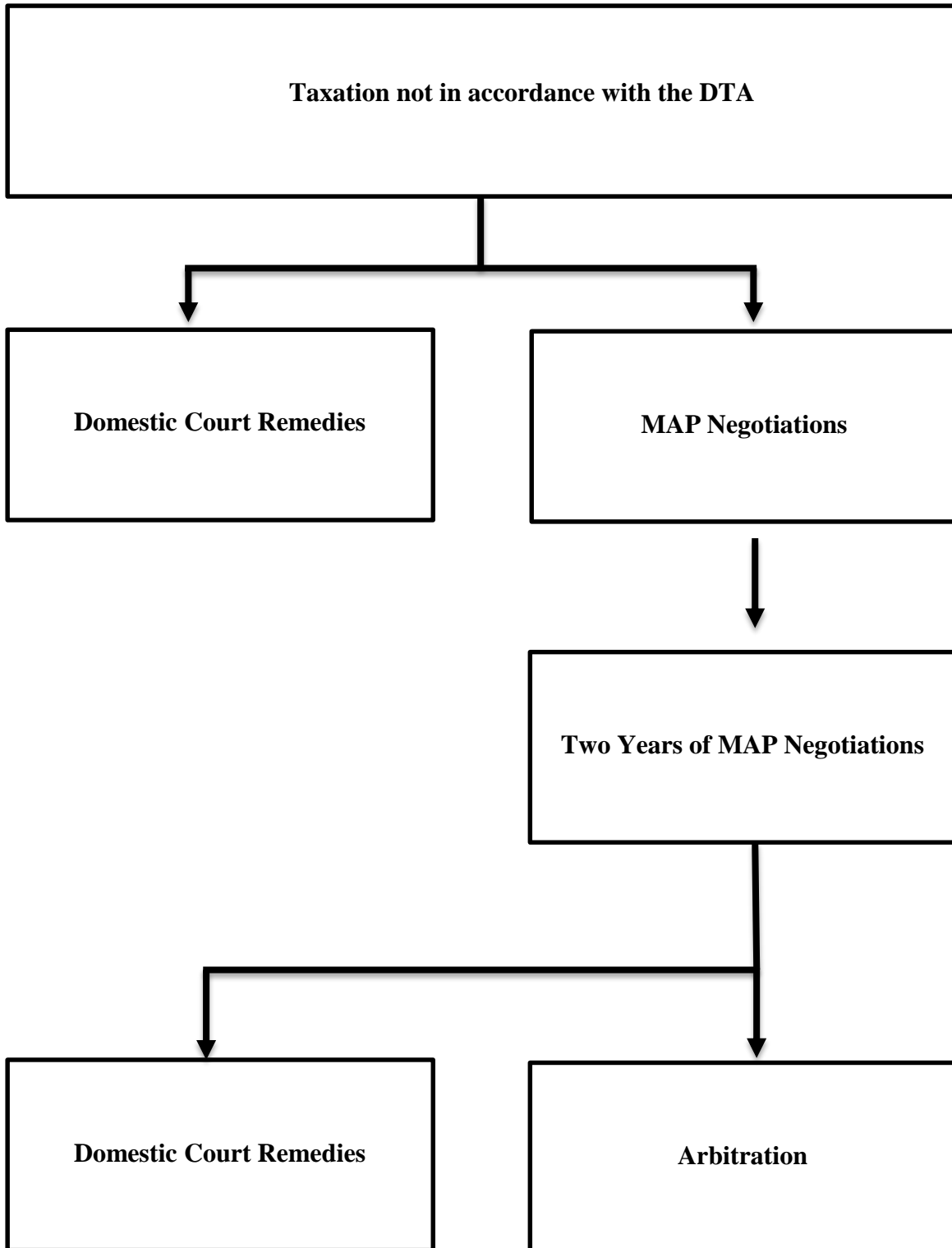
- a. under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and
- b. the competent authorities 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.³¹¹

³¹¹ In some States, national law, policy or administrative considerations may not allow or justify the type of dispute resolution envisaged under this paragraph. In addition, some States may only wish to include this paragraph in treaties with certain States. For these reasons, the paragraph should only be included in the Convention where each State concludes that it would be appropriate to do so based on the factors described in paragraph 65 of the Commentary on the paragraph. As mentioned in paragraph 74 of that Commentary, however, other States may be able to agree to remove from the paragraph the condition that issues may not be submitted to arbitration if a decision on these issues has already been rendered by one of their courts or administrative tribunals.

X Appendix Two

A Proposed New Dispute Resolution Process



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