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The Nature and Scope of the Mandatory Arbitration Provision in the OECD Multilateral Convention (2016)

In this article, the author considers the nature and scope of the mandatory arbitration provision in the OECD Multilateral Convention (2016) and discusses the effectiveness of the arbitration procedure.

1. Introduction

In recent years, the number of unresolved mutual agreement procedure (MAP) cases has significantly increased.[1] This is due to the fact that the MAP process does not always work properly and does not provide for mechanisms to enforce the resolution of a case. It is anticipated that, as a result of the implementation of the recommendations of the OECD/G20 Base Erosion and Profit Shifting (BEPS) initiative, the number of unresolved MAP cases will increase even more in the near future. In the Final Report on Action 14, entitled "Making Dispute Resolution Mechanisms More Effective", the OECD acknowledges this issue and discusses the use of mandatory arbitration as a way to resolve the gridlock.[2] In the Final Report, it was announced that, as part of the OECD Multilateral Convention (2016) (MLI),[3] mandatory arbitration provisions would be developed. These rules have been drafted by a Sub-Group on Arbitration, in which 27 states participated, and have been published in Part VI of the MLI ("Part VI").[4] Mandatory arbitration has, however, not been elevated to a minimum standard and applies only between states that are party to the MLI and explicitly choose to apply it with regard to their Covered Tax Agreements (CTAs).

At the time of writing this article, out of the 70 states that have signed the MLI, 26 had signed up for mandatory arbitration.[5] The list of states that have signed up for mandatory arbitration mainly consists of Western European industrialized states, with large outbound investment flows. The United States, which is an outspoken proponent of mandatory arbitration, is missing from the list, as it has not signed the MLI. There are very few developing countries on the list, which highlights the fact that such countries typically resist mandatory arbitration for fear of losing control over the source taxation of non-residents, which may constitute a large part of their total tax revenue.[6]

The European Union, as part of an initiative to create a fair and efficient corporate tax system, is to adopt an Arbitration Directive, which would complement and improve on the dispute settlement procedure to be found in the tax treaties between the Member States and the Arbitration Convention (90/436).[7,8] The objective of the EU Arbitration Directive is to increase legal certainty for taxpayers by extending the scope of the Directive beyond transfer pricing disputes, which are currently covered by the Arbitration Convention (90/436), and by providing enforcement mechanisms to ensure that the Member States cannot derail the dispute settlement process to the detriment of taxpayers.

The nature of the mandatory arbitration procedure in the MLI is similar to the mandatory arbitration procedure

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1. For the statistics on the number of initiated and resolved MAP cases in 2015, *see* www.oecd.org/tax/dispute/map-statistics-2015.htm.
2. OECD, *Action 14 Final Report 2015 – Making Dispute Resolution Mechanisms More Effective* (OECD 2015), International Organizations' Documentation IBFD [hereinafter: the "*Action 14 Final Report* (2015)"].
3. OECD, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (24 Nov. 2016), Treaties IBFD [hereinafter: the MLI].
4. OECD, *Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, para. 9, Treaties IBFD [hereinafter: the *Explanatory Statement*], also available at www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm.
5. That is, Andorra, Australia, Austria, Belgium, Canada, Fiji, Finland, France, Germany, Greece, Ireland, Italy, Japan, Liechtenstein, Luxembourg, Mauritius, Malta, the Netherlands, New Zealand, Portugal, Singapore, Slovenia, Spain, Sweden, Switzerland and the United Kingdom. For an overview of the country positions on the MLI, *see* www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf.
6. For an overview of the concerns developing countries have with mandatory arbitration, *see* M. Lennard, *International Tax Arbitration and Developing Countries*, in *International Arbitration in Tax Matters* ch. 19 (M. Lang & J. Owens eds., IBFD 2016) Online Books IBFD.
7. Council of the European Union, Proposal for a Council Directive on Double Taxation Dispute Resolution Mechanisms in the European Union (19 May 2017), available at http://data.consilium.europa.eu/doc/document/ST-9420-2017-INIT/en/pdf. For an overview of the scope of the EU Arbitration Directive of October 2016 and the revised proposal for an Arbitration Directive that was adopted by the Finance Ministers of the European Union (ECOFIN) in May 2017, *see* G. Groen, *The Scope of the Proposed EU Arbitration Directive*, 86 Tax Notes Intl. 3, pp. 243-254 (17 Apr. 2017) and *Why the Revised EU Arbitration Directive is a Big Step in the Right Direction*, 87 Tax Notes Intl. 5, pp. 475-479 (31 July 2017).
8. Convention 90/436/EEC of 23 July 1990 on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises (as amended through 2008), EU Law IBFD [hereinafter: Arbitration Convention (90/436)].

that is to be found in article 25(5) of the OECD Model.[9,10] Most importantly, mandatory arbitration in the MLI is construed as an extension of the specific case MAP of article 25(1) and (2) of the OECD Model and not as an independent appeals procedure. The MLI, however, contains certain procedural rules that are missing from the OECD Model, but are instead dealt with in the Commentary on Article 25(5) of the OECD Model[11] and the Sample Mutual Agreement on Arbitration that is annexed to the OECD Model.[12]

The fact that arbitration is construed as an extension of the specific case MAP means that the scope of the mandatory arbitration provision in the MLI is defined by the scope of the specific case MAP. Only those cases that fall within the scope of the specific case MAP may, if they cannot be resolved through a MAP, be resolved through arbitration. The scope of the specific case MAP is very broad. According to article 25(1) of the OECD Model, all actions resulting in "taxation not in accordance with the provisions of the convention" may be submitted to a MAP by an affected taxpayer. These cases may, therefore, include highly sensitive disputes that may challenge the tax sovereignty of a state. Such broad scope of the specific case MAP is, however, no real threat, as the competent authorities at any stage of the MAP remain in full control of the process and may decide to no longer engage with the other competent authority and leave a case unresolved.

With the introduction of mandatory arbitration, however, once a case has been accepted for a MAP, it will have to be resolved either by way of the MAP itself or through arbitration. In order to prevent the fact that sensitive cases will have to be resolved through arbitration, article 28(2) of the MLI permits states to formulate reservations with regard to the scope of cases that may be subject to arbitration. Not surprisingly, many states that have signed up for mandatory arbitration in the MLI have chosen to make such reservations.

The fact that mandatory arbitration is construed to be an extension of the specific case MAP also suggests that to the extent one or both of the competent authorities refuse to initiate a specific case MAP, such case can never be settled through arbitration. This is true for the mandatory arbitration provision of article 25(5) of the OECD Model. Some commentators have suggested that the introduction of mandatory arbitration in article 25(5) of the OECD Model may, therefore, have a detrimental effect on the willingness of competent authorities to accept certain sensitive MAP cases for fear that those cases might end up being decided by a third-party arbitration board.[13] The same appears to apply under the mandatory arbitration provision of the MLI.

The nature of the procedure as a state-to-state dispute settlement procedure and the limitations that states have placed on its scope question the effectiveness of the procedure in resolving treaty disputes, will be analysed further in this article. As the scope of the mandatory arbitration provision in the MLI and the specific case MAP are to a certain extent aligned, the author first discusses the nature and scope of the specific case MAP (*see* section 2.). The author then considers the nature and scope of the mandatory arbitration in the MLI (*see* section 3.). In particular, the author focuses on the reservations to the scope of mandatory arbitration that jurisdictions have formulated under article 28 of the MLI. The author concludes with some remarks on the effectiveness of the mandatory arbitration provision in the MLI (*see* section 4.).

2. The Nature and Scope of the Specific Case MAP

2.1. In general

In a MAP, the competent authorities of the contracting states may deal with "difficulties that arise out of a tax treaty in the broadest sense of the term".[14] A MAP is an international administrative procedure that is between the competent authorities only.

A MAP is, in essence, diplomatic in nature, as tax treaties typically do not grant specific procedural rights to taxpayers that provide direct access to an international dispute settlement procedure.[15] Taxpayers that suffer from an inconsistent interpretation or application of a tax treaty, therefore, have to solicit the help of the competent authorities of the contracting states to take their case to the international legal arena. Under diplomatic protection, the disputing states, however, maintain full control over every stage of the dispute settlement procedure. For instance, it is a well-established principle of diplomatic protection that a state can balance the interest of the harmed individual against broader public interest

9. Most recently, *OECD Model Tax Convention on Income and on Capital* (26 July 2014), Models IBFD.
10. The mandatory arbitration provision was first include in *OECD Model Tax Convention on Income and on Capital* art. 25(5) (17 July 2008), Models IBFD. For an evaluation of this provision, *see* H.M. Pit, *Arbitration under the OECD Model Convention: Follow-up under Double Tax Conventions: An Evaluation*, 42 Intertax 6/7, pp. 445-469 (2014). Even before the introduction of the mandatory arbitration provision in the *OECD Model* (2008), a number of tax treaties included voluntary or (semi-)mandatory arbitration provisions. For a discussion of these provisions, *see* G. Groen, *Arbitration in Bilateral Tax Treaties,* 30 Intertax 1, pp. 3-27 (2002).
11. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 25* (26 July 2014), Models IBFD.
12. The procedural rules that the competent authorities cannot deviate from in a Mutual Agreement on Arbitration are the Start Date of the Period before a Case becomes Eligible for Arbitration (article 19(5)-(9) of the MLI), Appointment of Arbitrators (article 20), Confidentiality of the Arbitration Proceedings (article 21), Resolution of a Case prior to the Conclusion of the Arbitration (article 22), Type of Arbitration Process (article 23), Agreement on Different Resolution (article 24) and Cost of Arbitration Proceeding (article 25).
13. *See*, for example, E. Farah, *Mandatory Arbitration of International Tax Disputes: A Solution in Search of a Problem*, 9 Fla. Tax Rev. 8, pp. 734-739 (2009). Farah, *supra*, refers to the rejection of a request for MAP assistance to prevent that a case may move to mandatory arbitration as the "Blocking Method".
14. Para. 1 *OECD Model: Commentary on Article 25* (2014).
15. This sets dispute settlement procedures under tax treaties apart from dispute settlement procedures under international investment agreements, which typically provide investors with direct access to an international procedure.

and international policy considerations and on that basis decide not to provide diplomatic protection.[16]

2.2. Scope of the specific case MAP and the role of the taxpayer

There are three distinct types of MAP under article 25 of the OECD Model. These are: (1) the specific case MAP of article 25(1) and (2) of the OECD Model; (2) the interpretative MAP of article 25(3), first sentence of the OECD Model; and (3) the legislative MAP of article 25(3), second sentence of the OECD Model. Part VI only provides for mandatory arbitration regarding issues that could not be resolved through a specific case MAP at the request of a taxpayer. Issues that could not be resolved through an interpretative or legislative MAP cannot be subject to mandatory arbitration, even though the competent authorities could decide, on a case by case basis, to submit such issues to arbitration.[17]

Under article 25(1) of the OECD Model, the specific case MAP can be set in motion by a taxpayer if "the actions of one or both of the Contracting States result or will result for him in taxation not in accordance" with the tax treaty. The subject matter scope of the specific case MAP is very broad. The actions referred to in article 25(1) of the OECD Model may be of a legislative or regulatory nature and may have general or individual application.[18] The type of cases that may be subject to a MAP may deal with legal and factual disputes over the interpretation or application of the tax treaty, but may also involve disputes over the interpretation or application of domestic (tax) laws, to the extent the tax treaty refers to such laws.[19] A taxpayer does not have to wait until the taxation considered by the taxpayer to be not in accordance with the tax treaty has actually been charged. All the taxpayer has to do is establish that such taxation is not merely possible, but probably so.[20] A taxpayer may also set the specific case MAP in motion even if the case does not involve judicial or economic double taxation, as long as the taxation is not in accordance with the tax treaty.[21]

Once the taxpayer has filed an application for a specific case MAP under article 25(1) of the OECD Model, the competent authorities should, under article 25(2) of the OECD Model, 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. The procedure, therefore, consists of two stages. The first stage is purely domestic between the taxpayer and the competent authorities, in which the competent authorities should try to resolve the case unilaterally if they consider the case to be justified. If the competent authorities consider the case to be justified and they cannot resolve the case unilaterally, only then may the case move to the second international stage. In this stage, the competent authorities endeavour to resolve a case in a bilateral manner, but are under no obligation to come to a resolution.[22]

The taxpayer has hardly any role to play in the second stage of a MAP. The access to the specific case MAP, the procedure itself and the implementation of the mutually agreed solution in the domestic legal order are all controlled by the competent authorities.

2.3. When is a MAP complaint justified?

The Commentary on Article 25 of the OECD Model (2014) does not provide any guidelines as to when a complaint is justified. All the OECD Commentary on Article 25 (2014) specifies is that a competent authority should not reject a taxpayer's complaint without good reason and without explaining what such good reasons might be.[23] The competent authorities, therefore, appear to have almost unlimited discretion to reject a case. Action 14 of the OECD/G20 BEPS initiative recognizes this and has recommended certain minimum standards and best practices to ensure that taxpayers that meet the requirements of article 25(1) of the OECD Model have access to a MAP.[24] In the 2017 proposed update to the OECD Model, which implements some of the minimum standards agreed under Action 14, a taxpayer can now file a complaint with the competent authorities of one, or both, of the contracting states, where before such complaint could only be filed with the competent authorities of the residence state. This ensures that both competent authorities are aware of the complaint and can share their views on whether a request for a MAP should be accepted or rejected.

The newly added paragraph 31.1 to the Commentary on Article 25 of the 2017 proposed update to the OECD Model, however, hardly provides any guidance on when it is appropriate to consider that the objection is justified. The OECD Commentary on Article 25 only states that it is reasonable to believe that a claim is justified if "there will be, in either of the Contracting States, taxation not in accordance with the Convention". The proposed updates to the OECD Model and the OECD Commentary on Article 25, therefore, leave the general framework of a MAP as a diplomatic procedure between the competent authorities in place and, as a result, the competent authorities can reject or discontinue cases at their own discretion.

The EU Arbitration Directive would take a completely different and innovative approach. Under the EU Arbitration

16. K. Parlett, *The Individual in the International Legal System: Continuity and Change in International Law* pp. 88-89 (Cambridge U. Press 2011).
17. Para. 73 *OECD Model: Commentary on Article 25* (2014).
18. Id., at para. 14.
19. F. Pötgens & F. Engelen, *Mutual Agreements* (FED Fiscale Brochures) para. 3.2. (Kluwer 2000).
20. Id.
21. Para. 13 *OECD Model: Commentary on Article 25* (2014). The *OECD Model: Commentary on Article 25* (2014) provides an example, whereby a contracting state taxes a certain type of income in respect of which the tax treaty gives an exclusive right to tax to the other state, even though the other contracting state does not exercise such right to tax under its domestic tax laws.
22. Id., at paragraphs 30-49 provides a more detailed description of the two stages of the specific case MAP. It has been argued that, in a strict sense, a MAP only consists of the second international stage of the procedure. *See* C. Silvani, *Dispute Resolution Procedures in International Tax Matters*, International Fiscal Association (IFA) Research Paper No. 5 para. III.B (24 Mar. 2014).
23. Id., at para. 34.
24. OECD, *Action 14 Final Report* (2015), *supra* n. 2.

Directive, a dispute between the competent authorities on the interpretation or application of a tax treaty could be submitted for a MAP, and if the MAP failed, mandatory arbitration. A decision to reject a case by all of the competent authorities could be reviewed by the national courts of the Member States involved and, if one but not all of the competent authorities rejects a case, an advisory commission would be formed to decide whether a request for a MAP is within the scope of the EU Arbitration Directive. This enforcement mechanism, which would give national courts and the advisory commission the competence to rule on issues concerning the scope of the MAP, would make it virtually impossible for the competent authorities to derail the MAP with regard to cases they are not sympathetic towards.[25] Such an enforcement mechanism is omitted from the MLI and the 2017 proposed updates to the OECD Model and the Commentary on Article 25 of the OECD Model.

2.4. Domestic guidelines on the application of the specific case MAP

Some states have published guidelines on the way that MAP requests will be handled.[26] Canada, for example, would reject a complaint under the specific case MAP if "the issue is not one that the Canadian and/or the foreign Competent Authority have decided, as a matter of policy, not to consider".[27] Under the French MAP guidelines, a MAP application under a tax treaty can be rejected if there is no double taxation. The Final Report on Action 14 also notes that some states may reject the initiation of a MAP if the transactions to which the request relates are considered to be abusive.[28]

Irrespective of the subject matter of the case, many jurisdictions also reject a MAP complaint regarding tax fraud, tax evasion, or wilful negligence or if a taxpayer has provided insufficient information to make a proper assessment of the case. A request for a MAP may also be denied where domestic court proceedings are ongoing or have resulted in a certain outcome. The local practices of states, therefore, reflect the principle that the competent authorities have a broad authority to reject a MAP.

Taxpayers have generally been unsuccessful in challenging a decision to reject a complaint before a domestic court. Recently, however, courts in Italy have been more receptive to a taxpayer's complaint, but, in general, courts worldwide grant the competent authorities almost unlimited freedom to reject a MAP case for whatever reason.[29]

3. The Nature and Scope of the Mandatory Arbitration under the MLI

3.1. The nature of the mandatory arbitration under the MLI

As discussed in section 1., the mandatory arbitration provision in the MLI functions as an extension of the specific case MAP and is not a separate (appeals) procedure. Mandatory arbitration, like the specific case MAP, is therefore construed as a procedure that takes place almost exclusively between the two disputing competent authorities with very limited involvement of the affected taxpayer. On the basis of article 19(10) of the MLI, the competent authorities themselves decide on the procedural rules of the arbitration proceedings, to the extent these have not been proscribed by the MLI, and on the basis of article 20 of the MLI, each of the competent authorities appoints a member to the arbitration panel. Under article 22 of the MLI, at any time during the arbitration procedure, but before the arbitration panel has delivered its decision, the competent authorities can also reach a mutually agreed solution, which terminates the arbitration procedure. Finally, according to article 22(4) of the MLI, the award by the arbitration panel must be converted through a mutual agreement that is entered into between the competent authorities and that reflects the outcome of the arbitration decision. It is apparent from these rules that the arbitration procedure is designed in a way that as little control as possible is transferred to the taxpayer, the arbitration panel or any other third party.

This is, furthermore, underscored by the fact that the default option for the arbitration procedure under article 23 of the MLI is the "last best offer" or "baseball" arbitration as opposed to the independent opinion approach favoured by the Commentary on Article 25 of the OECD Model and the EU Arbitration Directive.[30] Specifically, under article 23(1)(a) of the MLI, the competent authorities must formulate their position on the issue under dispute in specific monetary amounts, for example

25. *See* Groen, *The Scope of the Proposed EU Arbitration Directive*, *supra* n. 7, and *Why the Revised EU Arbitration Directive is a Big Step in the Right Direction*, *supra* n. 7.
26. For an overview, *see* Silvani, *supra* n. 22. *See also* Farah, *supra* n. 13, at para. II.D. *See also* the various country reports in the comparative study *Settlement of Disputes in Tax Treaty Law* (M. Lang & M. Züger eds., Kluwer 2003).
27. CA: Canada Revenue Authority (CRA), Information Circular 71-17R5, sec. 12.
28. OECD, *Action 14 Final Report* (2015), *supra* n. 2, at paras. 13-17. This recommends that access to the domestic stage of the MAP in cases that involve perceived abuse should not be rejected. OECD, *Action 14 Final Report* (2015), *supra* n. 2, however, clearly distinguishes between the domestic and international stage of the MAP and emphasizes that there is no obligation for the competent authorities to move such cases to the international stage of the MAP, and if they do, to reach an agreement. A new paragraph 26 of the 2017 proposed update to the *OECD Model: Commentary on Article 25* makes a similar point, and argues that "there is no general rule denying perceived abusive situations going to the mutual agreement procedure", but refers only to the domestic stage of the specific case MAP. It does, however, emphasize the fact that states must make clear the circumstances in which a state would deny access to a MAP in a tax treaty.
29. For an overview of court cases in Germany, Israel, Spain and the United States on this topic, *see* Silvani, *supra* n. 22, at para. III.C.5. The Italian *Corte Suprema di Cassazione* (Supreme Court of Cassation) recently acknowledged the jurisdiction of Italian courts to rule on administrative acts to deny access to the Arbitration Convention (90/436). In this respect, *see* D. De Carolis, *Jurisdiction of the Italian Judge on Administrative Acts Denying Access to the Arbitration Convention on Transfer Pricing: Towards a Dispute Resolution Procedure Ever More Independent of State Control*, 44 Intertax 2, p. 180 (2016).
30. For a description of the advantages and disadvantages of baseball arbitration with regard to treaty disputes, *see* R. Petruzzi, P. Koch & L. Turcan, *Baseball Arbitration in Comparison to Other Types of Arbitration*, in Lang and Owens eds., *supra* n. 6. *See also* S.P. Govind & L. Turcan, *The Changing Contours of Dispute Resolution in the International Tax World: Comparing the OECD Multilateral Instrument and the Proposed EU Arbitration Directive*, 71 Bull. Intl. Taxn. 3/4, sec. 2.3. (2017), Journals IBFD.

income or expense, or, where specified, the maximum rate of tax charged, and under article 23(1)(b) of the MLI they may provide a supporting position paper to the arbitration panel. In making its choice between the proposed resolutions, the arbitration panel cannot provide a rationale or any other explanation for its decision. The decision by the panel is not published, but instead is delivered to the competent authorities, who implement the decision through a mutual agreement. Under article 23(1)(c) of the MLI, the decision does not have precedential value.

The mandatory arbitration procedure, therefore, retains the nature of the specific case MAP as a purely state-to-state process. The only substantial improvement over the mandatory arbitration procedure of article 25(5) of the OECD Model is that, if one or both of the competent authorities fail to appoint a member of the arbitration panel in the manner and timeframe specified in article 19(2) of the MLI, a member is appointed by the highest ranking official of the Centre for Tax Policy and Administration (CTPA) of the OECD. Article 19(2) of the MLI does not specify how and by whom the CTPA should be notified of such failure, but the author assumes that, if the affected taxpayer notifies the CTPA of the fact that the arbitration process has been improperly stalled by the competent authorities, the CTPA must take appropriate action and appoint a member. This enforcement mechanism ensures that, once a case has moved to the international stage of a specific case MAP, the case is resolved at the request of the taxpayer.

3.2. The scope of mandatory arbitration

3.2.1. Opening comments

The subject matter scope of the mandatory arbitration procedure is defined by the scope of the specific case MAP as described in section 2.2. with certain limitations.

3.2.2. Only cases where tax has been charged

Under the wording of article 19(1)(a) of the MLI, only cases where taxes have actually been charged can be submitted to arbitration. This is because the article refers to:

> cases presented to the competent authorities on the basis that the actions of one or both of the Contracting Jurisdictions have resulted for that person in taxation not in accordance with the provisions of the Covered Tax agreements.

Cases where it is probable that actions of the contracting states may result in taxation not in accordance with the tax treaty in question, which fall within the scope of the specific case MAP, cannot be subject to arbitration. A similar position applies under the mandatory arbitration provision of article 25(5) of the OECD Model.[31]

3.2.3. No appeal in respect of rejection to initiate a specific case MAP

MAP cases that have been rejected by the competent authorities and have not made it to the international stage of a MAP, cannot be subject to mandatory arbitration under the MLI. As discussed in section 1., this position is clear under the mandatory arbitration of article 25(5) of the OECD Model. The Commentary on Article 25 of the OECD Model (2014),[32] for example, states that:

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

This position is, in the author's opinion, not different under the MLI. Only those MAP cases that have been accepted by both the competent authorities and have moved to the international stage of the MAP have to be resolved, either in the MAP or through arbitration. Cases that have been rejected by one or both of the competent authorities and never made it to the international stage of the MAP cannot be resolved through arbitration. The reference to mandatory arbitration is, therefore, somewhat misleading, from the perspective of the taxpayer at least, as only those cases that have initially been accepted by the competent authorities under the specific case MAP are ultimately resolved.

3.2.4. Reservations to the scope under article 28(2) of the MLI

Article 28(2)(a) permits the parties to the MLI to formulate one or more reservations with regard to the scope of cases that should be eligible for arbitration under Part VI. Such reservations are, under article 28(2)(b) of the MLI, subject to acceptance by the other contracting state to the CTA in question. Where a party to the MLI raises an objection to the reservation made, Part VI does not apply in its entirety between those parties. The Explanatory Statement to article 28(2) of the MLI explains that the creation of a list of certain defined reservations was considered, but that it was unlikely that consensus could be reached on such list between the members of the Sub-Group on Arbitration. There were also concerns that a jurisdiction that wished to join Part VI at a later stage but has strong policy concerns with regard to particular issues not referred to on the list, would decide not to join. Article 28(2) of the MLI, therefore, provides complete flexibility to tailor the scope of the cases that are eligible for arbitration on the basis of domestic policies regarding treaty arbitration. The ability to make such reservations may be regarded as reducing the effectiveness of the dispute settlement procedure, but it should be remembered that without such reservations the competent authorities might not wish to initiate the international stage of the MAP at all and by doing so would forgo the chance to arrive at a bilateral solution,

31. Paragraph 72 of the *OECD Model: Commentary on Article 25* (2014) states that: "[t]he arbitration process is only available in cases where the person considers that taxation not in accordance with the provisions of the Convention have actually resulted from the actions of one or both of the Contracting States; it is not available, however, in cases where it is argued that such taxation will eventually result from such actions even if the latter case may be presented to the competent authorities under paragraph 1 of the Article". This position is less clear under the EU Arbitration Directive, as article 1, which defines the subject matter scope of the Directive, merely refers to "disputes between member states when they arise from the interpretation or application of agreements and conventions that provide for the elimination of double taxation of income, and, where applicable, capital".
32. Id., at para. 68.

for fear of losing control over the process if they could not come to an agreement in a MAP.

Of the 26 states that have signed up for mandatory arbitration, only eight states have not made any reservations with regard to the scope of the arbitration.[33] All cases between the competent authorities of these states that have been accepted to the international stage of the MAP under article 25(1) and (2) of the OECD Model must, therefore, be resolved through a MAP or, if this fails, by way of mandatory arbitration at the request of the taxpayer.

Eighteen states have made reservations to the scope of the arbitration provisions in Part VI. The most common reservation involves the exclusion of cases concerning the application or interpretation of anti-abuse provisions from arbitration.[34] Most states only exclude disputes over the interpretation or application of domestic anti-abuse provisions from the scope of arbitration, but some of these jurisdictions also exclude disputes over the interpretation or application of tax treaty based anti-abuse provisions from the scope of arbitration.[35]

It is understandable that cases concerning the interpretation or application of domestic anti-abuse provisions are excluded from arbitration. These cases involve the interpretation of domestic law and may touch on issues as to whether, under constitutional law, domestic anti-abuse provisions can override tax treaties. Such disputes are entirely within the domestic legal sphere of the states involved and should not be dealt with by a third-party, semi-judicial, international arbitration panel. However, in the author's view, treaty-based anti-avoidance provisions should not be excluded from arbitration. These provisions are part of the tax treaty and should be interpreted in good faith and applied in a consistent way by the contracting states. The author sees no reason why treaty-based anti-avoidance provisions should be excluded from arbitration.

Certain states exclude cases that do not involve double taxation from the scope of arbitration.[36] It is unfortunate that these reservations have been made, as cases of double non-taxation or low taxation may be entirely legitimate under a tax treaty and not be the result of aggressive tax planning. For instance, many tax treaties apply a 0% withholding tax rate on dividends paid to jurisdictions that apply a participation exemption. Disputes over the applicable withholding tax rate in such cases do not necessarily involve treaty shopping by a taxpayer and should, therefore, be resolved through arbitration.

Certain states also exclude from arbitration cases involving dual resident persons, i.e. individuals and entities, while others limit the scope to dual resident entities only.[37] It is reasonable that states wish to exclude disputes regarding the residency of entities from arbitration. These cases may involve abusive situations, and under article 4 of the MLI and article 4 of the proposed update to the OECD Model, which implements some of the recommendations from the Final Report on Action 6,[38] dual resident entities can no longer claim treaty benefits pending the outcome of a MAP deciding the residency of such entity. In addition, no clear guidelines are provided on what basis residency should be established and how to weigh the various criteria that might be applied. It would be contrary to the goal and intent of this provision to force a resolution of such cases within a certain timeframe by a third-party, semi-judicial, arbitration panel that is not provided with any guidance on how to resolve the dispute.

Some states exclude cases from arbitration where both competent authorities agree that the case is not suitable for arbitration.[39] This provides flexibility to those jurisdictions to exclude certain unforeseen cases that challenge the tax sovereignty of the states involved and have not been covered by other reservations to the scope of the mandatory arbitration provision. In this respect, it should, however, be noted that, in case one party insists on settling the dispute through arbitration, the other party can, in principle, not prevent this from happening.

Certain states do not exclude certain cases from arbitration, but, instead, list the types of cases that can be submitted to arbitration. Canada, for example, indicates that only those issues arising from a provision similar to article 4 of the OECD Model (Residence, but only with respect to individuals), article 5 (Permanent establishment), article 7 (Business profits), article 9 (Associated enterprises), article 12 (Royalties, but only insofar as between related parties to which a provision similar to article 9 applies) and any other provisions subsequently agreed by the contracting parties through an exchange of diplomatic notes can be submitted to arbitration. Portugal adopts a similar approach and only permits issues arising under provisions similar to article 5 of the OECD Model (Permanent establishment), article 7 (Business profits) and article 9 (Associated enterprises) to be submitted to arbitration. Both of these states, therefore, limit arbitration to more factual transfer pricing cases and the question of the existence of a permanent establishment (PE).

33. That is, Belgium, Fiji, Liechtenstein, Luxembourg, the Netherlands, Malta, Switzerland and the United Kingdom.
34. That is, Australia, Austria, Finland, Germany, Ireland, Italy, Mauritius, New Zealand, Portugal, Singapore, Slovenia and Spain.
35. That is, Germany, Italy, Portugal and Spain.
36. That is, Finland, France, Germany, Italy, Portugal, Slovenia and Spain. The approach of Spain is interesting, as it only applies the reservation to cases of double non-taxation involving transfer pricing disputes. Article 15(7) of the EU Arbitration Directive also permits cases that do not involve double taxation to be excluded from the dispute resolution procedure on a case-by-case basis.
37. Italy and Slovenia exclude cases involving dual resident persons from the scope, while Japan and Sweden only exclude cases involving dual resident entities from the scope of arbitration. Paragraph 73 of the *OECD Model: Commentary on Article 25* (2014) explicitly states that mandatory arbitration provision of article 25(5) of the *OECD Model* (2014) applies to unresolved MAP cases concerning the dual residency of individuals initiated under article 4(2)(d). The proposed update to the *OECD Model: Commentary on Article 25* makes no explicit statement regarding MAP cases concerning dual resident entities.
38. OECD, *Action 6 Final Report 2015 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* (OECD 2015), International Organizations' Documentation IBFD.
39. That is, France, Spain and Sweden.

Germany does not permit arbitration with regard to facts that have been established in an agreement between the taxpayer and the tax authorities concerning the facts of a case and does not permit arbitration in respect of cases involving the application of any domestic law or treaty provision to items of income or capital resulting in the avoidance of double taxation by the credit method instead of the exemption method. France does not permit arbitration in respect of cases that involve tax of less than EUR 150,000.[40]

The reservations to the scope of the mandatory arbitration provision do not only deal with the subject matter of the case, but also with the characteristics of the taxpayer and the interaction with domestic and international dispute settlement procedures. A detailed discussion of these reservations is beyond the scope of this article. In summary, a number of jurisdictions do not permit a case that involves a taxpayer that has been subject to a penalty for tax fraud, wilful default or gross negligence, etc. to be submitted to arbitration.[41] Some jurisdictions also exclude from the scope of mandatory arbitration cases that fall within the scope of the Arbitration Convention (90/436) or under other instruments agreed by the Member States of the European Union, such as the EU Arbitration Directive.[42]

4. Conclusions: The Effectiveness of Mandatory Arbitration

Mandatory arbitration in the MLI is construed as an extension of the specific case MAP. Its legal framework is similar to the mandatory arbitration provision of article 25(5) of the OECD Model. The procedure is, in essence, diplomatic in nature, as a taxpayer does not have direct access to the international procedure. In the dispute settlement procedure it is the competent authorities involved that represent the interest of the taxpayer affected, which may not necessarily be aligned with the interests of the competent authorities themselves. The taxpayer affected also has no legal standing at any stage of the procedure

In the author's opinion, the biggest defect of the mandatory arbitration procedure is that it lacks an enforcement mechanism that enables a national court or an arbitration panel at the request of a taxpayer to scrutinize whether the rejection of the competent authorities to move a claim to the international stage of the MAP was justified. To call arbitration "mandatory" is, therefore, misleading from the perspective of the taxpayer, as the competent authorities can block a dispute from ever being resolved at the international level.

The MLI permits states to make reservations with regard to the scope of mandatory arbitration. Within the current legal framework of the dispute settlement process, this is understandable, as this permits the competent authorities to, at least, move sensitive cases to the international stage of the MAP and try to resolve them in a bilateral manner, without having to fear that they may lose control over the dispute settlement procedure if they cannot come to a resolution in a MAP. The reservations by certain states on the scope of the mandatory arbitration provision are, however, too broad. There is, for example, no justification to exclude cases involving the application of treaty-based anti-avoidance rules or cases not involving double taxation from arbitration. It also remains to be seen whether the states that have signed up for mandatory arbitration will accept the reservations that other states have made. If states reject the reservations of certain other states, the mandatory arbitration provisions will not be applicable between those states.

It is unfortunate that, in its desire to come to a compromise to attract as many states to sign up for mandatory arbitration as possible, the Sub-Group for Arbitration maintained the status quo and did not change the legal framework of the dispute settlement procedure. This is to a certain extent understandable, as states have legitimate concerns about the erosion of their tax sovereignty through aggressive tax planning and have to ensure that the settlement of certain cases remains within their control. The problem with the current dispute settlement procedure is that it leaves too many escape clauses for the competent authorities to not fulfil their treaty obligations in bona fide cases.

In the author's view, a better balance between the competing interests of providing certainty to taxpayers and safeguarding the tax sovereignty of states could have been found by dividing the dispute settlement procedures in the following two clearly distinct procedures: (1) one more judicial in nature and; (2) the other diplomatic and/or administrative in nature. The judicial dispute settlement procedure should be truly mandatory from the perspective of the taxpayer and should include a specific case MAP followed by mandatory arbitration if a case cannot be resolved through a MAP. The procedure should contain clearly defined limitations on its scope, very strict enforcement rules along the lines of the EU Arbitration Directive and provide for more taxpayer participation throughout the process. The administrative and/or diplomatic procedure should deal with all other cases that do not fall within the scope of the judicial mandatory MAP and/or arbitration provision. Such a procedure could be designed along the lines of the current MAP in the OECD Model and should also contain an interpretative and legislative MAP.

40. The EU Arbitration Directive does not contain a minimum monetary threshold for cases to be considered. In fact the EU Arbitration Directive makes it easier in article 15(a) for individuals and small undertakings to settle cases under the Directive.
41. That is, Finland, France, Germany, Ireland, Italy, Mauritius, Portugal, Slovenia and Spain. The wording of these exceptions may vary according to the jurisdiction. A similar limitation to the scope of mandatory arbitration can be found in article 15(6) of the EU Arbitration Directive. This exception is, in the author's opinion, not appropriate as it violates the "*non bis in idem*" principle, as a taxpayer is punished twice for the same action through the imposition of a penalty as well as through the imposition of double taxation.
42. That is, Finland, France, Germany and Spain. Finland only excludes those cases where an actual application has been filed under the Arbitration Convention (90/436) or any other EU instrument, such as the EU Arbitration Directive.