Florida Journal of International Law

Volume 7 | Issue 2 Article 3

June 1992

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Sharon A. Reece

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*Sharon A. Reece**

Every nation has an inherent right to levy taxes according to its own laws.[1] Consequently, unrelieved double taxation may arise as a result of international economic transactions which collide with national interests.[2] Double taxation is threatened when, inter alia, the domestic laws of various states interact and multiple jurisdictions claim the property or the residence status of a taxpayer.[3] Conflicting interpretations of treaty provisions and adjustments in transfer pricing[4] between related enterprises operating in multiple states may also create the double taxation of related companies. These conflicts were viewed as hazardous to international trade, and threatened to interrupt the fabric of international commerce.[5]

International law does not define the jurisdictional prerogatives to tax.[6] Consequently, unilateral attempts to avoid double taxation were made by some states in the form of a tax credit where the state of residence allowed a credit for the tax levied in the host state.[7] Subsequently, a more bilateral approach was introduced in the form of bilateral treaties of friendship, commerce and navigation which contained certain rudimentary tax provisions generally relating to inter-

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* Associate Professor of Law, Albany Law School, Union University; B.A., 1973, University of West Indies; M.A., 1975, Long Island University; J.D., 1978, Hofstra University; LL.M., 1986, New York University.

1. J. van Hoorn, Jr., *Problems, Possibilities and Limitations with Respect to Measures Against International Tax Avoidance and Evasion*, 8 GA. J. INT'L & COMP. L. 763, 764 (1978).

2. Klaus Vogel, *Double Tax Treaties and Their Interpretation*, 4 INT'L TAX & BUS. L. 4 (1986).

3. H. David Rosenbloom & Stanley I. Langbein, *United States Tax Treaty Policy: An Overview*, 19 COLUM. J. TRANSNAT'L L. 359, 361 (1981).

4. Transfer pricing refers to the adjustment in transactions between commonly controlled entities on the basis of an arms length standard as if the enterprises were independent.

5. *See* Rosenbloom & Langbein, *supra* note 3, at 361.

6. *See* Vogel, *supra* note 2.

7. The Foreign Tax Credit is covered in I.R.C. §§ 901-908. The foreign tax credit was first introduced in the Revenue Act of 1918 and it allowed a credit against the United States Tax of the tax paid to a foreign country. *See* Rosenbloom & Langbein, *supra* note 3; *see also* McDonnell, *Foreign Exchange and the Indirect Foreign Tax Credit*, 10 J. COMP. TAX'N 301, 303 (1984).

national shipping activities.[8] These agreements preceded the existence of tax treaties.[9]

The emergence of the more sophisticated bilateral income tax treaties to avoid double taxation signaled an era of international reciprocity and cooperation in the division of revenues between nations.[10] The objective was that these treaties would encourage economic activities within the borders of each contracting state, while at the same time preserving each state's ability to collect taxes from these activities.[11] The post-World War I period saw a proliferation of bilateral tax treaties in response to the increasing tax rates designed to alleviate the burden of the war.[12] These treaty initiatives attempted to avoid double taxation and thereby promote international tax harmony by delineating the tax jurisdictions of treaty partners, thereby enhancing predictability in international tax relationships.[13]

The Organization of European Economic Cooperation (OEEC) and its successor, the Organization for Economic Cooperation and Development (OECD) produced the first model income tax treaty in 1963, after years of extensive bureaucratic analysis. This was revised in 1977 and more recently in 1992.[14] The OECD model addressed primarily treaty negotiations between developed countries.[15] Additionally, a group of experts appointed by the United Nations Economic and Social Council developed a model treaty in 1980 to serve the interests of developing countries.[16] The U.S. Treasury Department published its

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8. *See* Stanley S. Surrey, *Factors Affecting U.S. Treasury in Conducting International Tax Treaties*, 28 J. TAX'N 277 (1968); *see generally* Van Raad, *A Survey of the U.S. FCN Treaties*, 15 TAX MGMT. INT'L J. 135 (1986); Carl Estes, *Tax Treaties*, 14 INT'L LAW. 508 (1980).

9. RICHARD M. HAMMER, NEW YORK UNIVERSITY FIFTH INTERNATIONAL INSTITUTE ON TAX AND BUSINESS PLANNING, 1977 TAX TREATIES AND COMPETENT AUTHORITY 165 (Virginia di Francesco & Nicolas Liakas eds., 1978).

10. H. David Rosenbloom, *Current Developments in Regard to Tax Treaties*, 40 INST. ON FED. TAX'N §§ 31.01, .03, at 31-24 (1982).

11. *Id.*

12. *See generally* Surrey, *supra* note 8.

13. Stanley E. Novack, Tax Treaty Division: Cooperation In Resolving Competent Authority Issues, 301 PLI/Tax 879, PLI Order No. J4-3639 (1990).

14. *See* Committee on Fiscal Affairs, Organization for Economic Co-Operation and Development (OECD), Model Double Taxation Convention on Income and Capital 19-192 (1977 & 1992) [hereinafter OECD Model Treaty].

15. Robert J. Patrick, Jr., *A Comparison of the United States and OECD Model Income Tax Convention*, 10 LAW & POL'Y INT'L BUS. 613 (1978).

16. *See* Manual for the Negotiation of Bilateral Tax Treaties Between Developed and Developing Countries, U.N. Doc. ST/ESA/94 at 161-164 (1979).

own model treaty in 1977 which was used as the point of departure for U.S. treaty negotiations and a revised model was published in 1981.[17]

The typical tax treaty will contain, inter alia, substantive provisions dealing with residency and domicile,[18] source and type of income,[19] dividends,[20] interest,[21] royalties[22] and the definition of the permanent establishment[23] of a foreign enterprise, and allocation of income among related parties.[24] They also provide for exchange of tax information to assist in international enforcement.[25] In addition, all the model treaties, and most of the treaties with the U.S. (except the treaty with Ireland and with Bermuda), contain a dispute resolution clause referred to as "The Mutual Agreement Procedure."[26]

The problem resolution clause of the mutual agreement procedure becomes operative whenever double taxation is threatened or real, or whenever disputes arise from interpretations of various provision of the treaty. It is anticipated that as international tax authorities scrutinize international transactions and as domestic legislations undergo revision, new areas of discord between treaty partners will be sparked.[27]

This mechanism to resolve potential tax treaty disputes is essentially controlled by the respective countries' "competent authorities," who are designated tax officials from each signatory country, and who have the power to confer with each other, either on their own initiative,

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17. U.S. Treasury Proposed Model Convention Between the United States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion (1981), *reprinted in* 3 R. RHOADES & M. LANGEN, INCOME TAXATION OF FOREIGN RELATED TRANSACTIONS § 15.04(25) (1987) [hereinafter U.S. Model Treaty]. For a detailed comparison of the U.S., OECD, and U.N. model treaties, *see generally Committee on United States Activities of Foreign Taxpayers, New York State Bar Association Tax Section, Report Proposed United States Model Income Tax Treaty*, 23 HARV. INT'L L.J. 219 (1983).

18. OECD Model Treaty, *supra* note 14, art. 4.

19. *Id.* art. 2.

20. *Id.* art. 10.

21. *Id.* art. 11.

22. *Id.* art. 12.

23. *Id.* art. 5.

24. *Id.* art. 9.

25. *Id.* art. 26.

26. *Id.* art. 25; *see also* apps. I, II, and III for model mutual agreement procedure clauses in the OECD model, the U.N. model, and the U.S. models respectively.

27. Paul M. Badner, *International Taxation: Competent Authorities Share Their Concerns*, 32 TAX NOTES 573, 574 (1986); Jeanne N. Covington, *Dispute Resolution Under Tax Treaties: Current and Proposed Methods*, 24 TEX. INT'L L.J. 367 (1989).

or at the behest of a taxpayer to attempt a resolution of a treaty issue.[28] The competent authorities are instructed by treaty language to "endeavor" to resolve each case by mutual agreement; no binding resolution or conclusion of the matter is mandated.[29]

This article does not represent a comprehensive survey of bilateral income tax treaties. It serves the more limited purpose of examining the objectives of the dispute resolution mechanism in these treaties and suggests that international tax arbitration should be explored as a replacement for the current mutual agreement procedure in these treaties.

Taxpayers who have been subjected to tax liabilities in a way they believe departs from the treaty agreement itself, or taxpayers who seek to resolve interpretive issues of a treaty, may initiate relief through the mutual agreement procedure.[30] Treaty interpretations in a mutual agreement will be ordinarily sustained if the interpretive agreement is not inconsistent with the treaty.[31] The competent authorities themselves may address issues relating to the elimination of double taxation in cases not provided for in the convention,[32] and they can communicate directly or through their representatives.[33] The validity of this authority in its attempt to eliminate double taxation in cases not provided for in the tax treaty has been questioned and debated among the scholars concerning its apparent grant of legislative authority to the competent authorities.[34]

The mutual agreement procedure clause in model treaties are similar to the OECD model;[35] however, the U.S. model, in addition, states specific issues with which the competent authorities may agree.[36] The

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28. For model versions of the mutual agreement procedure in appendices, *see supra* note 26.

29. OECD Model Treaty, *supra* note 14, art. 25(3). The idea of a competent authority was first seen in the United States Tax Treaty with Switzerland in 1939. Convention and Protocol with Sweden Respecting Double Taxation, Mar. 23, 1939.

30. U.S. Model Treaty, *supra* note 17, art. 25(3).

31. John F. Avery Jones et al., *The Legal Nature of the Mutual Agreement Procedure Under the OECD Model Convention — I*, 6 BRIT. TAX REV. 333, 346 (1979).

32. OECD Model Treaty, *supra* note 14, art. 25(3).

33. *Id.* art. 25(4).

34. John F. Avery Jones et al., *The Legal Nature of the Mutual Agreement Procedure Under the OECD Model Convention — II*, 1 BRIT. TAX REV. 13, 17 (1980).

35. *See* app. I, *supra* note 26.

36. *See* app. III, *supra* note 26, art. 25(3).

U.N. model also conforms to the OECD model but further provides that

> [t]he competent authorities, through consultations, shall develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedure provided for in this article. In addition, a competent authority may devise appropriate unilateral procedures, conditions, methods and techniques to facilitate the above-mentioned bilateral actions and the implementation of the mutual agreement procedure.[37]

Under the treaties in force with the United States, the Assistant Commissioner (International) functions as the U.S. competent authority, with the assistance of the tax treaty division.[38] An issue involving legal interpretations of treaties requires the concurrence of the Associate Chief Counsel.[39] In other countries the competent authority frequently is not part of the taxing authority (many even lack expertise in tax matters) and may not have direct control over the tax administrators.[40] This can impact the entire process since there is the possibility that the competent authority in such a jurisdiction may be reluctant to reach a result it cannot enforce.[41]

In the United States a special group of personnel are assigned to engage in mutual agreement negotiations and certain other treaty functions.[42] This group is not involved in the day-to-day activities of audit and collection.[43] In other nations, however, mutual agreement functions are performed within the same existing administrative structures that handle the assessment and collection of taxes.[44] It is not unusual, therefore, to find that the same individual who initially made an allocation is also the person to negotiate with the competent author-

37. *See* app. II, *supra* note 26, art. 25(4).

38. Rev. Proc. 91-23, 1991-1 C.B. 534.

39. *Id.*; Deleg. Order No. 114 (Rev. 9), 1990-33 I.R.B. 13.

40. Sanford H. Goldberg, *U.S.A.: Competent Authority*, 40 BULL. FOR INT'L FISCAL DOCUMENTATION 431 (1986).

41. *Id.*

42. George Goodrich, *Canada-U.S. Tax Accounting: Competent Authority, § 482 Transfers and Joint Audits*, 4 CAN.- U.S. L.J. 151, 158 (1981).

43. *Id.*

44. *Id.*

ity of the treaty country.[45] Thus, taxpayers may be unwilling to submit detailed records to the tax administrators of two jurisdictions in order to solve a legitimate issue.[46] Each country can adopt precise procedure to access the mutual agreement procedure. However, in a survey conducted by the author it was shown that many countries which have treaties with the U.S. have issued no procedural guidelines with respect to invoking this procedure and a letter is sufficient to activate the process.[47]

The United States and Canada however, have imposed very detailed guidelines on taxpayers seeking to access assistance from competent authorities under the mutual agreement procedure in treaties with the United States. The Internal Revenue Service recently updated its method of handling mutual agreement procedure matters, and Rev. Proc. 91-23,[48] is now the only Revenue Procedure which governs the entire competent authority process.

The United States Competent Authority will only consider requests from United States residents or citizens once administrative review with appeals have been pursued.[49] A request will be denied if the competent authority determines that the taxpayer is not entitled to any benefits or safeguards under the treaty[50] or if the taxpayer is only willing to accept an agreement that may be prejudicial to the United States.[51] The taxpayer is therefore forced to function in the unnatural role of considering the interests of its government in trying to achieve a resolution of an adversarial tax issue. Other disqualifying actions include the taxpayers insistence on participating in the negotiations,[52] the failure to furnish sufficient information,[53] the failure to

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45. *Id.*

46. G.K. Kwatra, *Arbitration in International Tax Matters: A New Approach*, 5 J. INT'L ARB. 151-64 (1988).

47. THE INTERNATIONAL INSTITUTE ON TAX AND BUSINESS PLANNING, NEW YORK UNIVERSITY, POLLAND, The Use of Competent Authority Articles, the British view 274 (Di Francesca ed., 1977). Countries responding to the same survey conducted by the author, who did not have formal internal rules to access the mutual agreement procedure include Pakistan, Australia, the Netherlands, Grenada, Austria, China, Denmark, Malta [hereinafter Survey Response].

48. Rev. Proc. 91-23 supersedes Rev. Proc. 82-29, 1982-1 C.B. 481, which dealt with allocation issues, and Rev. Proc. 77-16, 1977-1 C.B. 573, which dealt with non-allocation issues.

49. Rev. Proc. 91-23, *supra* note 38, § 3.05.

50. *Id.* § 11.02.

51. *Id.*

52. *Id.*

53. *Id.*

comply with the controlling revenue procedure[54] and the failure to generally cooperate with the competent authority and the Internal Revenue Service.[55] Denial of a taxpayer's request for assistance from competent authorities is not subject to review.[56]

Upon acceptance of a case, a competent authority analyst processes the case by gathering pertinent documents and prepares a recommendation for the competent authority.[57] Negotiations are typically initiated by the competent authority submitting a position memorandum to the foreign competent authority requesting the desired relief.[58] Once the process is activated, the various representatives typically share their news through written communications, and propose reconciliation ideas.[59] The representatives then prepare any tentative agreement for the signature of the competent authority. The form of the negotiating procedure depends on the countries involved, and negotiations may be conducted either orally or in writing.[60] The taxpayer is not, however, generally bound by the agreement that has been reached between the competent authorities. If the taxpayer chooses to accept the agreement, it is not subject to further judicial or administrative scrutiny and the taxpayer may be asked to sign a closing agreement.[61]

Many aspects of the competent assistance process renders it burdensome and possibly ineffective as a mechanism to resolve international tax disputes. The taxpayer has a very limited role in the process.[62] The primary role of the taxpayer seeking relief is to submit documentation as often as requested by the competent authorities.[63] The taxpayer is under a continuing obligation to "supply any additional information needed to resolve the case and keep the competent authority informed about proceedings in the treaty country or any other pertinent developments."[64] Failure to supply the required documenta-

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54. *Id.*

55. *Id.*

56. *Id.* § 11.04; John E. McDermott, Jr., *IRS Reorganizes the Competent Authority Process*, 2 J. INT'L TAX'N 55 (1991).

57. *See* Novack, *supra* note 13.

58. *Id.*

59. *Id.*

60. *Id.* Survey response determined that Pakistan, Australia, The Netherlands, Austria, China and U.K. all conduct negotiations in writing. The Canadian and U.S. competent authorities frequently have face-to-face negotiations.

61. Rev. Proc. 91-23, *supra* note 38, § 11.05.

62. *Id.*

63. *Id.* § 11.01.

64. *Id.*

tion or any "additional information" are grounds for denial of assistance.[65] The taxpayer must also consent to disclose to the foreign competent authority any of the items submitted.[66] In fact, the United States competent authority reserves its right under the applicable treaty to disclose such information even in the absence of consent.[67] The competent authority process is expensive[68] and can extend for years.[69] This may be in part attributable to the attempt to resolve complex factual issues without the taxpayer or legal representation and the bureaucratic delays inherent in solving a case by written communication. The delays can also exacerbate interest accrual on proposed adjustments during the period that the case is undergoing the competent authority process.[70] This can be quite substantial when one considers the impact of the fluctuation of foreign currency.[71]

The taxpayer is not represented by legal counsel at the negotiations[72] and has no right to attend or participate in the negotiation process.[73] These rules of exclusion may create a feeling of helplessness and distrust of the entire process. This lack of direct taxpayer participation can prove detrimental to a case especially when complex factual issues are debated. After an extended period of time and considerable expense to the aggrieved taxpayer, the competent authorities may be unable to reach an agreement or the binding effect of an agreement may be questioned.[74] The latter potential varies from country to country. In Belgium and the United Kingdom a mutual agreement is not binding[75] whereas in Norway, a mutual agreement automatically becomes incorporated into the domestic laws.[76]

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65. *Id.* § 11.03.

66. Howard M. Liebman, *Confidentiality of Information in Competent Authority Proceedings*, 5 INT'L TAX J. 442, 445 (1979).

67. *Id.*

68. Glen L. Meadre, *International Pricing: Allocation, Guidelines and Relief from Double Taxation*, 10 TEX. INT'L L.J. 131 (1975).

69. *See generally* Joseph L. Andrus et al., *Competent Authority Assistance in Tax Controversies Under the New IRS Procedures*, 50 TAX NOTES 1279 (1991).

70. *Id.*

71. *Id.*

72. *Id.*

73. *Id.*

74. Arvid Aage Skaar, *Tax Policy Forum: The Legal Nature of Mutual Agreements Under Tax Treaties*, 92 TAX NOTES INT'L 95-11 (Dec. 21, 1992).

75. J.D.B. Oliver, *Some Aspects of the Territorial Scope of Double Tax Treaties*, 9 BRIT. TAX REV. 303 (1990); *see also* Avery Jones et al., *supra* note 31.

76. *Id.*

Small claims are not encouraged.[77] The attitude of treaty signatories to the competent authority process varies. For example, some countries publish decisions creating an advantage for taxpayers from these countries; others treat the decisions as confidential material.[78] Since the disclosure of any sensitive information submitted by the taxpayer is mandated, the prospects of such information being disseminated to foreign governments which may have less stringent rules concerning trade secrets and litigation certainly presents a risk that many may not be willing to take.[79] It must also engender a feeling of distrust for a taxpayer to rely on tax authorities to solve a double tax issue.[80]

Where an agreement is unsatisfactory to the taxpayer or an agreement is not reached, the taxpayer has to then enter a third round of legal maneuvering (after the administrative review and the competent authority process) at a substantial cost of time and money. In the case of *Boulez v. Commissioner*,[81] the competent authorities were unable to resolve a double taxation problem. During the year in question, 1975, Petitioner Boulez, a world renowned musician, was a French citizen, a resident of Germany and a non-resident alien in the United States for income tax purposes. He contracted with CBS Records, a division of CBS United Kingdom Ltd. which is a subsidiary of CBS, Inc., a United States company, to serve as a producer and/or performer for the phonography recording of a musical and/or literary composition. Petitioner performed these services in the United States, and was paid the sum of $39,461.47 by CBS. He reported this amount on his German Income Tax return and paid the appropriate tax due. On his 1975 U.S. non-resident alien income tax return, petitioner disclosed the amount, but excluded it from U.S. income tax. The United States Internal Revenue Service assessed a deficiency in petitioner's individual income tax, asserting that the entire amount was taxable by the United States.

The Federal Republic of Germany argued that the payments constituted "royalties" within the meaning of Article VIII of the U.S.-Germany tax treaty and pursuant to the treaty were taxable exclusively by the Federal Republic of Germany. The United States on the other hand asserted that the income was payment for the performance of

77. Lionel Blumenthal, *Host Country: U.K.*, 12 TAX MGMT. INT'L J. 24 (1991).

78. In survey response, only Austria published decisions.

79. *See* Andrus et al., *supra* note 69.

80. Nancy H. Kaufman, *Dispute Resolution Under Tax Treaties, The Developing Role of the Competent Authority*, 3 WIS. INT'L L.J. 101 (1984).

81. Boulez v. Commerce, 83 T.C. 584 (1984).

services and was therefore taxable by the United States. Boulez initiated proceedings before the competent authorities to resolve the potential double tax interest in this conflict; however, they were unable to agree on the correct classification of the income. Competent authorities had no obligation to settle the taxpayer's problem, but their task was complete once an "effort" to achieve an agreement was made. Boulez then proceeded to the Tax Court, where judgment was given in favor of the United States. It was no doubt that petitioner Boulez had to commence further proceedings with considerable expense in search of a resolution.

A procedure which does not guarantee a decision should not be the dominant mechanism to resolve international tax disputes where an alternate procedure, arbitration, has functioned effectively to resolve disputes arising from international commercial transactions.

IN DEFENSE OF INTERNATIONAL TAX ARBITRATION

Support for arbitration in international tax matters has been escalating, and the utilization of arbitration in income tax treaties has been recognized in the hierarchy of international tax policy objectives. In fact, the establishment of an autonomous and independent arbitral institute to address international tax matters has been proposed,[82] with a scenario of three arbitrators, one appointed by each state and the chairperson agreed to by both.[83] Any award would be final and binding.[84] The commentators vary on the type of arbitration rules to utilize. Some believe, as does the author, the current internationally accepted arbitration rules and institutes could be adapted for use in the context of international tax matters.[85] Most proposals, however, would anchor an arbitration procedure to the competent authority

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82. GUSTAV LINDENCRONA & NILS MATTSSON, ARBITRATION IN TAXATION 92 (1981); Avery Jones et al., *supra* note 31; Avery Jones et al., *supra* note 34; Kaufman, *supra* note 80; Sandford H. Goldberg, *How and Does the Competent Authority Work? A Multinational Analysis*, 39 THE TAX EXECUTIVE 5, 44 (1986); Maktouf Lofti, *Resolving International Tax Disputes Through Arbitration*, 4 ARB. INT'L 32-51 (1988); Oliver, *supra* note 75; *Forum: Competent Authority Assistance for Relief from Double Taxation*, 12 TAX MGMT. INT'L J. 20 (1991); Leif Mutén, *New Germany-Sweden Tax Convention Examined*, 5 TAX NOTES INT'L 531-35 (Sept. 14, 1992) (tax) PT23547.

83. LINDENCRONA & MATTSSON, *supra* note 82, at 111.

84. *Id.*

85. *See* Covington, *supra* note 27.

process,[86] thus making arbitration operative only when the Mutual Agreement Procedure has failed.[87]

Under the aforementioned proposal, arbitration would be two procedures removed under a tax treaty since administrative review and appeals must be first exhausted, prior to initiating the mutual agreement procedure. Given the delays inherent in an administrative review with appeals, and the delays inherent in the competent authority process in particular, it is submitted that this approach would render the arbitration option meaningless. No justification is evident for resolving international tax matters in this manner.

An Arbitration Procedure Clause should replace the current Mutual Agreement Procedure in bilateral income tax treaties, thereby providing a neutral forum to resolve international tax disputes, in which the goal is to achieve a final binding solution. There is indeed a palpable need for a procedure to resolve international tax matters in which contracting states are compelled to be bound by decisions of impartial experts, and in which the international investor taxpayer has greater representation.[88]

The use of arbitration in taxation has been advanced most consistently to deal with issues of transfer pricing adjustments.[89] In fact, cases involving transfer pricing form the bulk of issues referred to the Competent Authority.[90] In the period between 1971 through 1985 the United States Competent Authority reported a total of 484 dispositions in allocation cases and 323 dispositions in nonallocation cases.[91] It has further been estimated that intercompany pricing cases represent 65% of the total number of requests received and over 95% of the total dollars considered.[92]

The European Community members adopted an arbitration-like provision in their multilateral convention to address transfer pricing

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86. *Id. see* LINDENCRONA & MATTSSON, *supra* note 82; Kaufman, *supra* note 80.

87. LINDENCRONA & MATTSSON, *supra* note 82, at 113; Kaufman, *supra* note 80; Covington, *supra* note 27.

88. *See generally* LINDENCRONA & MATTSSON, *supra* note 82; Kaufman, *supra* note 80.

89. Rom P. Watson, *New Developments in Transfer Pricing Rules*, 17 BROOK. J. INT'L L. 61 (1991).

90. Goldberg, *supra* note 82, at 38-39.

91. *Id.*

92. Venuti, Competent Authority Under Tax Treaties, Presented at World Trade Institute Seminar (Dec. 3-4, 1990), p. 8; Robert T. Cole, *New Competent Authority Procedure: Allows for Increased Flexibility*, 74 J. TAX'N 390 (1991).

issues. This was done in the form of an advisory commission.[93] Under this convention, if after conferring with each other the competent authorities are unable to arrive at an acceptable agreement to eliminate double taxation, they must establish an advisory commission to resolve the matter.[94] Upon notification of an impending price adjustment which is not agreed to, the taxpayer may submit the claim to the appropriate competent authority;[95] if an agreement is not reached, the competent authorities must establish an advisory commission[96] and adhere to the decision of this commission.[97]

The advisory commission is established on an ad hoc basis to hear disputes under the convention and consists of a chairman, two representatives of each competent authority and independent persons drawn from a list of independent persons of standing which is maintained by the Secretary General of the Council of the European Communities.[98] Competent authorities are barred from disclosing information containing trade secrets.[99] The taxpayer can have private representation before the commission.[100] A decision from the advisory commission must be forthcoming within six months from submission.[101]

The United States-Germany Treaty was the first treaty with the U.S. to include an arbitration provision.[102] The arbitration provision was, of course, framed in deference to the mutual agreement procedure. It provides that "if a disagreement cannot be resolved by the competent authorities, it may, if both competent authorities agree, be

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93. Convention 90/463 on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises, art. 7(1), 1990 O.J. (L225) 10, 13. Arbitration is not compulsory under this convention.

94. *Id.*

95. *Id.* art. 6.

96. *Id.* art. 7(1).

97. *Id.*

98. *Id.* art. 9.

99. *Id.* art. 9(6).

100. *Id.* art. 10(2).

101. *Id.* art. 11.

102. Tax Convention with the Federal Republic of Germany, art. 25(1), S. TREATY DOC. NO. 10, 101st Cong., 2d Sess. 67 (1990), *reprinted in* 2 Tax Treaties (CCH) ¶ 3249. Article 26 of the U.S.-Mexico Treaty contains an arbitration clause similar to the U.S.-Germany Treaty. This provision is only operative after the competent authorities are deadlocked for two years. *See* Turro, *U.S. and Mexico Sign Long-Awaited Income Tax Treaty and Protocol*, 56 TAX NOTES 1692 (1992).

submitted for arbitration. . . ."[103] Subsequently, the Treaty between the United States and the Netherlands provide that,

> if any difficulty or doubt arising as to the interpretations or application of this Convention cannot be resolved by the competent authorities in a mutual agreement procedure pursuant to the previous paragraphs of this Article, the case may, if both competent authorities and the taxpayer(s) agree, be submitted for arbitration, provided the taxpayer agrees in writing to be bound by the decision of the arbitration board. The decision of the arbitration board in a particular case shall be binding on both States with respect to that case. The provisions of this paragraph shall have effect after the States have so agreed through the exchange of diplomatic notes.[104]

The insistence on a supplementary role for arbitration reflects a conflict between the desire for certainty in resolving international tax disputes and the apparent reticence of sovereign states to cede jurisdiction of claims arising from the matters which may impact on the public fisc.[105] Arbitration, however, satisfies the policy goals of efficiency, neutrality and certainty,[106] and should therefore not be relegated to a supplementary role. The efficiency gains that arbitration would generate in terms of uniformity should be available to any taxpayer operating in the international arena.

Arbitration has been increasing in the context of international agreements in general.[107] This boost in arbitration is partly attributable to the fact that arbitration allows the parties to agree on the rules of the game.[108] Arbitrators can be chosen with particular expertise in

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103. Convention between the U.S. and the Netherlands for the Avoidance of Double Taxation (1992) art. 29(5), *reprinted in* 2 Tax Treaties (CCH) ¶ 6103.05 (1992); "U.S.-Dutch Treaty Reflects Changes Policies and Economic Forces," 4 JOIT 104 (Nov. 1993).

104. Convention between the U.S. and the Netherlands for the Avoidance of Double Taxation (1992) art. 29(5), *reprinted in* 2 Tax Treaties (CCH) ¶ 6103.05 (1992).

105. Meadre, *supra* note 68; *see also* ORGANIZATION FOR ECONOMIC CO-OPERATION & DEVELOPMENT, COMM. ON FISCAL AFFAIRS, TRANSFER PRICING AND MULTINATIONAL ENTERPRISES: THREE TAXATION ISSUES 11, 34 (1984) [hereinafter THREE TAXATION ISSUES].

106. Meadre, *supra* note 68; THREE TAXATION ISSUES, *supra* note 104.

107. Hans Bagner, *Enforcement of International Commercial Contracts by Arbitration: Recent Developments*, 14 CASE W. RES. J. INT'L L. 573 (1982).

108. Christine Lecuyer-Thieffry & Patrick Thieffry, *Negotiating Settlement of Disputes Provision in International Business Contracts: Recent Developments in Arbitration and Other Processes*, 45 BUS. LAW. 577, 591 (1990).

the area[109] and arbitration adds finality to the issue.[110] The neutrality, speed and the fact that the taxpayer can participate fully and have access to legal counsel are also responsible for its growing popularity.[111] In short, "arbitration has been able to keep its place among international institutions of dispute resolution."[112]

Arbitration has been deemed appropriate to resolve issues which relate to domestic and public policy matters.[113] The United States case law[114] reflects an endorsement of the use of arbitration to resolve International Commercial disputes even where the claims related to fundamental public policy issues such as those raised by antitrust laws.[115] Arbitration agreements and awards are also enforceable under the 1958 New York Arbitration Convention,[116] which has been ratified by most western industrialized countries and many developing countries.[117]

Proponents of the competent authority process urge that remedial measures are afoot to improve and streamline the current process.[118] Modification goals include the resolution of cases in two years,[119] more face to face meetings between the competent authorities[120] and a more active role for the taxpayer in developing the cases.[121] Notably absent from the suggested improvements is the goal of having a more definite goal of resolution of a disputed treaty issue. The resolution of a taxpayer's legitimate concerns should not depend on continued goodwill among the competent authorities, political persuasion or the maintenance of political status quo. Taxpayers deserve a more sanguine perspective of protections under bilateral income tax treaties.

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109. Douglas D. Reichert, *Provisional Remedies in the Context of International Commercial Arbitration*, 3 INT'L TAX & BUS. L. 368, 369 (1986).

110. *Id.*

111. *See* Bagner, *supra* note 107.

112. Louis B. Sohn, *The Role of Arbitration in Recent International Multilateral Treaties*, 23 VA. J. INT'L L. 171 (1983).

113. *Id.*

114. *See* Brennen v. Zapata Off-Shore Co., 407 U.S. 1, 92 S. Ct. 1097 (1972); Scherk v. Alberto-Culver Co., 417 U.S. 506, 94 S. Ct. 2449 (1974).

115. Soja Mentschikoff, *Commercial Arbitration*, 61 COLUM. L. REV. 846 (1961).

116. The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards gives signatories to the Convention the power to enforce arbitral awards rendered in signatory states. 9 U.S.C. §§ 201-208 (1988) codifies 1958 New York Convention.

117. *See* Mentschikoff, *supra* note 115.

118. Presentation given by Regina M. Deanehan, IRS Assistant Courier (Int'l), at the IRS & G.W.U. 5th Annual Institute on Current Issues in Int'l Taxation, Dec. 14-15 (1992).

119. *Id.*

120. *Id.*

121. *Id.*

Arbitration may not be a panacea to avoid all the concerns associated with the competent authority process, but it represents a type of formal adversarial proceeding with an opportunity for examination and cross-examination. This offers a more predictable outcome to the parties. More importantly, arbitration must result in a definitive decision which is binding. In contrast, the competent authority is saddled with the impossible task of representing the interests of both the government and the taxpayer, in search of a compromise. These are clearly conflicting and competing interests at work here. The taxpayer must also accommodate the interests of the government or face the risk of denial of assistance from a competent authority altogether.

Arbitration applies judicial procedures rather than political compromise. The competent authority process, on the other hand, represents a diplomatic exercise which is less suitable to resolving complex tax treaty issues, especially in the absence of direct contribution from the taxpayer seeking relief.[122] Arbitration is more efficient and more flexible.[123] It offers a less expensive and swifter method of settling disputes and affords the parties a neutral mode of dispute resolution which eliminates local prejudice.[124]

An arbitration clause in income tax treaties would signal a commitment to certainty in dispute resolution.[125] The utilization of institutional arbitration[126] in the international tax arbitration context should receive acceptance by both the developing and developed countries since both

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122. Joanne K. Lelewer, *International Commercial Arbitration as a Model for Resolving Treaty Disputes*, 21 N.Y.U. J. INT'L L. & POL. 379 (1989); Mary M. Lovik, *Anatomy of a Dispute Clause: Intergovernmental Arbitration Under the Spacelab Agreement*, 5 HASTINGS INT'L & COMP. L. REV. 397, 398 (1982).

123. Lelewer, *supra* note 122; Louik, *supra* note 122.

124. Lelewer, *supra* note 122; Louik, *supra* note 122; John T. Schmidt, *Arbitration Under the Auspices of the International Centre for the Settlement of Investment Disputes (ICSID): Implications of the Decision on Jurisdiction in* Alcoa Minerals Inc. v. Government of Jamaica, 17 HARV. INT'L L.J. 90, 103-04 (1976).

125. Kenneth R. Simmonds et al., *Roundtable: Public International Arbitration*, 22 TEX. INT'L L.J. 149 (1987).

126. Convention on the Settlement of Investment Disputes Between States and Nationals of other States made in Washington Mar. 18, 1965, 17 U.S.T. 1270, T.I.A.S. No. 6090, 575 U.N.T.S. 159 (entered into force for the U.S. Oct. 14, 1966), codified at 22 U.S.C. §§ 1650, 1650(a) (1970) [hereinafter ICSID Convention]). International Tax Arbitration could utilize the International Centre for the Settlement of Investment Disputes, which provides facilities of an international nature to accommodate arbitration of investment disputes between states and nationals of other states pursuant to the ICSID Convention.

participated in the process that created the ICSID,[127] and the provisions of the convention reflected a sensitivity to the concerns of developing states wishing to attract foreign investors.[128]

Although arbitration has been proposed for income tax treaties and the lack of a compulsory dispute resolution has been criticized,[129] few nations have grasped the opportunity to include arbitration provision as an alternative to the competent authority process.[130] The question remains, "is arbitration in income tax treaties to be or not to be?" An arbitration procedure would transcend the effectiveness of the mutual agreement procedure.

The resistance to and suspicion of arbitration traditionally harbored by developing countries, due to the notion that international arbitration is biased and tainted in favor of developed countries,[131] is disappearing. Developing countries are becoming more receptive to international arbitration;[132] they provide a more secure environment to developing states since "in law all states are considered equal."[133]

CONCLUSION

Today, there exists a motley array of income tax treaties worldwide. The increase in tax treaty executions and multi-national and international transactions signals the need to reassess the efficacy of the current dispute resolution mechanism of tax treaties. Compulsory arbitration would auger a new era in dispute resolution under

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127. Report of the Executive Directors on the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States Mar. 18, 1965, *reprinted in* ICSID, Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Documents Concerning the Origin and Formulation of the Convention, Vol. II pt. 2, at 1069, 1073 (1968).

128. *Id.*; *see also* Michael M. Moore, *International Arbitration Between States and Foreign Investors, The World Bank Convention*, 18 STAN. L. REV. 1359, 1360 n.6 (1966).

129. *See* Avery Jones et al., *supra* note 82.

130. Robert G. Clark, *Transfer Pricing, Section 482 and International Tax Conflict; Getting Harmonized Income Allocation Measures from Multinational Cacophony*, 42 AM. U. L. REV. 1155 (1993).

131. Kwatra, *supra* note 46, at 161; M. Sornorajah, *The Climate of International Arbitration*, 8 J. INT'L ARB. 47 (1991); Bruce G. Rinker, *The Future of Arbitration in Latin America*, 8 CASE W. L.J. 480 (1976); H.A. Grigera-Naon, *Latin American: Overcoming Traditional Hostility Towards Arbitration* 1988, at 1, PLI Commercial Law and Practice Course Handbook Series International Commercial Arbitration No. 375 (1988); *see also* Shikata, ICSID and Latin America, 1 News from ICSID, No. 2, at 2 (1984). Latin American countries which have ratified the ICSID Convention include, Panama, Ecuador, El Salvador and Paraguay.

132. *See* Grigera-Naon, *supra* note 131.

133. *Id.* For a detailed survey of recent trends in International Commercial Arbitration *see* Lecuyer-Thieffry & Thieffry, *supra* note 108, at 577.

the income tax treaty. The time is at hand to develop a more progressive approach to international tax disputes which are both sensitive to the needs of the taxpayers and responds to the declared international policy favoring arbitration. Indeed parties can always reach a settlement during the arbitral process; however, the prospect of a binding award may motivate the parties to bargain seriously and efficiently.

APPENDIX I - OECD 1992 Model

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 provision of the Convention.

2. The competent authority shall endeavor, 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 endeavor 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 for the purpose of reaching an agreement in the sense of the preceding paragraphs. When it seems advisable in order to reach agreement to have an oral exchange of opinions, such exchange may take place through a Commission consisting of representatives of the competent authorities of the Contracting States.

APPENDIX II

Article 25 of the United Nations Model Double Taxation Convention Between Developed and Developing Countries provides as follows:

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under 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 endeavor, 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 this 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 endeavor 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 for the purpose of reaching an agreement in the sense of the preceding paragraphs. The competent authorities, through consultations, shall develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedure provided for in this article. In addition, a competent authority may devise appropriate unilateral procedures, conditions, methods and techniques to facilitate the above-mentioned bilateral actions and the implementation of the mutual agreement procedure.

U.N. Doc. No. 57/ESA/102/1980.

APPENDIX III

Article 25 of the 1981 U.S. Model is a quite similar model and provides as follows:

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or national.

2. The competent authority shall endeavor, 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 or other procedural limitations in the domestic law in the Contracting States.

3. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. In particular the competent authorities of the Contracting States may agree

(a) to the same attribution of income, deductions, credits, or allowances of an enterprise of a Contracting State to its permanent establishment situated in the other Contracting State;

(b) to the same allocation of income, deductions, credits, or allowances between persons;

(c) to the same characterization of particular items of income;

(d) to the same application of source rules with respect to particular items of income;

(e) to a common meaning of a term;

(f) to increases in any specific amounts referred to in the Convention to reflect economic or monetary developments; and

(g) to the application of the provisions of domestic law regarding penalties, fines and interest in a manner consistent with the purposes of the Convention.

They may also consult together for the elimination of double taxation in cases not provided for in the Convention.