ARBITRATION AS A TOOL TO RESOLVE INTERNATIONAL TAX DISPUTES

by

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ABSTRACT

Arbitration has grown tremendously as an effective mechanism in resolving disputes. While it was initially accessed in resolving commercial disputes, the timely resolution of disputes, expertise of the arbitrators and lesser compliances has led to its proliferation. The subject-matter of arbitration has been steadily increasing to an extent that even tax matters, which are considered to be a major contributor to the economic base of any given country is also referred to arbitration. The question whether tax disputes can be arbitrated or not was for long in vogue, receiving different views. This paper tries to identify arbitration as an effective tool on resolving international tax disputes. The paper is divided into two parts for better understanding. The first portion deals with a general understanding of tax and arbitration, while the second deals with the Mutual Agreement Procedure adopted under the Model Tax Conventions and a perusal of BEPS Action Plan 14, which is a part of minimum standards to make dispute resolution more effective.

KEY WORDS: Arbitration, International Tax, Mutual Agreement Procedure.

INTRODUCTION

Arbitration, in simple terms can be defined as a situation in which a private judge or arbitrator, as agreed upon by the parties under a contract, is given the task of settling a dispute by issuing an arbitration award. It is a private way to settle a dispute. Arbitrators are therefore distinct from judges as they have the power to state the law, but not the power to apply it. However, the reality shows that arbitration is not an out of court settlement, but settlement of disputes with the assistance of court(s) which can be inferred from the perusal of the Arbitration and Conciliation Act, 1996 which has a list of Sections where the arbitrator seeks the assistance of the court. Other characteristics of arbitration includes, timely resolution of the dispute and methods of recourse against the final award of an arbitrator, and the fact that the autonomy of an arbitration clause should be recognised, as it can be separated from the rest of the contract *(i.e., if a contract is null and void following a competition violation, this does not nullify the arbitration clause)*[1]. Finally, it is the arbitrator who pronounces his or her competence to take on the matter rather than the state *(so-called principle of 'competence-competence')*[2].

Arbitration is usually adopted in cases involving commercial issues between the parties, a simple example being resolving disputes arising out of a contract. However, arbitration could also be used in situations involving a state's body where there is no commercial relationship, between the parties, the example being an arbitration between a company and a competition authority.

Arbitration can either be international, in which case the arbitrator has a wider freedom to establish the framework of the procedure, or domestic in which the arbitrator must apply a number of rules and regulations related to public policy.

With the increase in the number of commercial disputes and proliferation of arbitration as a preferred method of settlement of disputes, the types of disputes that can be resolved by arbitration is also steadily increasing. The arbitrability of Tax disputes is one such issue which has been the subject of intense debate throughout the world.

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[1] Section 16 of the Arbitration and Conciliation Act, 1996 - Competence of arbitral tribunal to rule on its jurisdiction.—(1) The arbitral tribunal may rule on its own jurisdiction, including ruling on any objections with respect to the existence or validity of the arbitration agreement, and for that purpose,— (a) an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract; and (b) a decision by the arbitral tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause…………..

[2] *Ibid.*

This paper is an attempt to bring about an acceptable answer to the debated question that, *'can a dispute relating to Tax Law be the subject-matter of arbitration?'*

UNDERSTANDING THE CONCEPT OF TAX

The word 'tax' denotes a burden paid for general good to the public without any expectation of direct benefit or definite return. In the words of **Adam Smith,** "Tax is a compulsory acquisition of money by the State without any quid pro quo".[3]

Tax is mandatorily a legal collection, which can be imposed only by an authority of law as it is an incidence of sovereignty.[4] Tax is a compulsory contribution by the tax payer. By "Compulsory" we mean that tax is mandatory and it is an obligation of every person earning beyond the basic exemption limit to pay tax.

There is no ***quid pro quo*** between the tax payer and the authority. The maxim ***quid pro quo*** means "one for another". This phrase is used when something is given in return for some work done. However, there is no concept of ***quid pro quo*** in tax as the State does not give any direct benefit to the taxpayer for the amount of tax paid.

The aim of tax is to raise public revenue and thereby increase the welfare of the community as a whole. Tax may be imposed on property, profession, commodity, etc.

THE NEED FOR ADR MECHANISMS IN INTERNATIONAL TAX DISPUTES WITH SPECIAL REFERENCE TO ARBITRATION

The proliferation of double taxation avoidance agreements has created a new branch of tax laws as these agreements come into play when a resident of one state has a source of income from another state. The problem mostly lies in the interpretation of these treaties. In order to avoid the problems of interpretation on a global level most of these treaties are based upon three model conventions namely,

- The OECD Model Convention;
- The UN Model Convention;
- US Model Convention.

[3] "What is tax?-Adam Smith, Definition and Canons", (http://kalyan-city.blogspot.in/2010/12/what-is-tax-definition-adam-smith.html), (Accessed on:- 15.12.2020)
[4] *New Delhi Municipal Committee v. State of Punjab*, 1995 AIR, 3 1994 SCC (6) 619.

THE MUTUAL AGREEMENT PROCEDURE

Both the OECD and UN Model Conventions are analogous or similar. Article 25 of these Model Conventions provides an opportunity to the taxpayer who is of the view that he would not be taxed in terms of the Convention as a result of the actions of the Contracting states, to present his case to the competent authority of the contracting state to which he is a resident. In the given situation, an obligation to resolve the case is on the relevant competent authority, who has to do it by mutual agreement. The core of adopting the Mutual Agreement Procedure (MAP) entails the fact that the taxation is not in accordance with the Convention, in circumstances where the input from the contracting states involved is required. On the other hand, if the taxation is a result of one of the contracting states, there is no requirement of MAP and it should be resolved by unilateral measures.

MAP, as we can understand is only a venture to agree upon a resolution as there is no obligation placed on the competent authorities to go for it. MAP can happen only when the taxpayers consider an imposition outside the scope of the tax treaty and makes a request for MAP within 3 years of occurrence of the event calling for the same. Also, the fact that there is no fixed timeline for the conclusion of MAP shows that it simply is not a system of litigation rather a system of consultation.

Though the timeline for conclusion of MAP is not fixed, it is shown that the duration is considerably brief. This in no way leads to an inference that the taxpayers have reached an equitable outcome in all cases. Past experiences shows that MAP is closed by disagreement primarily because of the reluctance of the contracting states to launch a precent which could prove detrimental for them. To add to it, the official MAP statistics which rely on self-reporting and measure only average completion times which means cases which simply fail are excluded from it.

While MAP in the majority of the cases is said to work better for the taxpayers, the important demerit is conclusion of MAP without considering the merits of a given case. This happens when two contracting states have various ongoing MAP with each other at a given time, engages in horse trading, as a result of which all unresolved cases are resolved at a single swipe. This results in reaching at a conclusion without adequately considering the merits of the case. Resolving disputes in this manner can cause harm to taxpayers when the rights to tax their income are divided between two jurisdictions with extremely different tax rates.

MAP AND BEPS ACTION 14

Acknowledging MAP's shortcomings, the Base Erosion and Profit Shifting (BEPS) Action Plans has allocated a separate action plan (Plan 14), to make dispute resolution most effective. More specifically, the Final report on Action 14 published in October 2015 comprises a number of minimum requirements and best practises aimed at improving the MAP. Certain features of the Multilateral Instruments have now been formalised based on it.

The Final Report contains the following three minimum standards.[5]

1. Firstly, states ought to ensure complete implementation of treaty obligations related to MAP in good faith. To achieve which, the states are placed with an obligation to incorporate into their tax treaty provisions paragraphs 1 to 3 of Article 25 of the OECD's Model Convention which set out the fundamental MAP mechanics.
2. Secondly, states must warrant the administrative processes adopted by each of them encourages the timely resolution of treaty-related disputes. This calls from each state to provide appropriate guidance and sufficient resources to the competent authorities playing a role in MAP.
3. Finally, presently MAP must be filed only to the Contracting state to which the taxpayer is a resident leaves complete discretion to one of the states to accept/reject the request for MAP. This should be allowed no more, as a result of which it is recommended that the taxpayer should be given the opportunity to make the MAP request to either of the relevant contracting states. This ensures the fact that the authorities involved will be able to offer their views on the acceptance or otherwise, which avoids arbitrariness in arriving at a conclusion.

The other best practices include the part where the relevant contracting states ought to take measures to suspend the collection of tax when a MAP request is pending. The suspension should be made available under the same criteria as a person seeking a home remedy. Given the potentially adverse cash flow consequences of double taxation while the MAP is ongoing, the use of this best practise for taxpayers will prove fruitful.

[5] OECD/G20 Base Erosion and Profit Shifting Project, Making Dispute Resolution Mechanisms More Effective, Action 14 - 2015 Final Report.

ARBITRATION AS A MEANS OF SETTLING DISPUTES UNDER THE OECD MODEL

A provision for arbitration was first added to the OECD Model Convention in 2008 in Article 25(5). It reads as follows:

"Where,

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

b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the date when all the information required by the competent authorities in order to address the case has been provided to both competent authorities,

any unresolved issues arising from the case shall be submitted to arbitration if the person so requests in writing. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph".[6]

This provision provides a scope for arbitration when MAP is not a success. Arbitration, here, is made to stand independent, which mean sit does not require any prior authorisation. Once the procedural requirements are met, it is made mandatory. Here, the agreement to arbitrate is established before to the occurrence of a dispute, and arbitration is required in all circumstances where an issue has not been addressed. Thus, mandatory arbitration stands out from optional arbitration which is present in certain income tax treaties, which allows

[6] OECD Model Tax Convention on Income and on Capital.

contracting states to retain a degree of discretion by deciding whether or not to submit disputes to arbitration on a case-to-case basis.

MANDATORY ARBITRATION AS A SYSTEM TO OVERCOME THE DEFECTS OF MAP SYSTEM

The undeniable demerit in the optional arbitration is that, it allows the competent authorities of the relevant contracting states to act according to their interests, wherein if the consider a case unfavourable to their interests they can always reject it. This, in turn will discourage the taxpayers and will be act as a passive force to refrain from devoting time and money in MAP. In this regard, a purely optional arbitration system does not provide appropriate protection as there is no obligation for the contracting states to achieve an agreement under the MAP. Treaties that express the expectation that contracting states will choose to arbitrate a dispute have little practical utility, and if such arbitration provisions are ever implemented, delays will be unavoidable owing to the requirement to draught each arbitration agreement on a case-by-case basis.

We should also be aware of the fact that the mandatory arbitration adopted by the OECD Model does not dispel all the erstwhile issues with the MAP system. a perusal of the Model convention shows that mandatory arbitration will be triggered only when the competent authorities are unable to agree to a resolution. This means that the same admission restrictions that apply to taxpayers seeking redress through the MAP also apply to taxpayers seeking arbitration. That is, contracting states may halt the possible arbitration of a disputed matter before the MAP's quasi-obligation for contracting states to attempt to resolve the disagreement takes effect. Before accepting a MAP request, a contracting state must first determine whether it "appears to be reasonable." If a contracting state does not believe a taxpayer's request is legitimate, one of the MAP's prerequisites is not met, then the topics in dispute cannot continue to obligatory binding arbitration. The link between the MAP and arbitration and the fact that arbitration is only an extension to the MAP perhaps weakens its effectiveness as a vehicle for taxpayer assertion of rights.

Another distinguishing feature of arbitration under the OECD Model Convention and the conventional arbitration system is that, under the Model Convention, arbitration is not an independent process to resolves disputes and assert taxpayers' rights. This is because, mandatory binding arbitration can come into play only when there is an unresolved issue which formed part of MAP. Thus, the initiation point of arbitration is indeed the failure of the contracting states to resolve an issue within 2 years of its first being presented under the MAP. This clears that arbitration is only a backstop to MAP.

Arbitration, as a subset of the MAP, also raises the issue of the consequences of an arbitral decision. The OECD Model Convention states that the decision is "only binding with respect to the specific issues submitted to arbitration," which gives contracting states some leeway to agree on various aspects of the MAP after an opinion is provided. The OECD Model Commentary also includes alternative language for states that want to expressly allow competent authorities to deviate from an arbitration decision if they can agree on a different solution.

Arbitration as a subset of the MAP likewise brings up the issue of what the results of an arbitral choice are. The OECD Model Convention gives that the choice is "just restricting as for the particular issues submitted to arbitration" which leaves contracting states with some extension freely to concur different parts of the MAP ensuing to an assessment being advertised. The OECD Model Commentary additionally gives substitute language to states which wish explicitly to allow able specialists to withdraw from the arbitral award a where they can settle on an alternate arrangement.

It is note-worthy that the European Union (“EU”) Arbitration Convention also assumes this method. It is feasible to envision drafting which accommodates arbitral choices to be obligatory on the relevant competent authorities and the taxpayers to the barring of any remaining elements. Be that as it may sound, it is additionally conceivable to envision arbitral choices which are only advisory on the competent authorities. Thus, the OECD Model and the EU Arbitration Convention give a trade-off position between an arbitral choice which blocks further inclusion from contracting states and one that gives a last and steady resolution.

CONCLUSION

Arbitration as an effective mechanism of resolving disputes has grown tremendously. Tax, which is one of the basic means of revenue generation of any economy making it crucial to the economic base of any country. The question whether tax disputes can be subjected to arbitration is a question open to varied views. However, the Model Tax Laws and the BEPS Action Plan which seeks to fight tax avoidance has recognised and accepted arbitrability of tax disputes as an effective dispute resolution mechanism. In the international arena of taxation which needs specific knowledge and expertise to resolve the disputes, we could conclude that, arbitration will serve as an effective method of dispute resolution. Therefore, the view that tax disputes should be kept out of the purview of arbitration as it will be a greater threat to the revenue of the country if the economic base of the country is left to private arbitrators should be disregarded. However, mechanism can be adopted to keep track of the happenings of arbitration to achieve its effectivity in entirety.

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