Putting Arbitration on the MAP: Thoughts on the New U.N. Model Tax Convention

by Allison Christians

The U.N.’s tax committee last month released its latest version of the U.N. model tax convention, designed for use between developed and developing countries. The big news in the 2011 update consists of the addition of “arbitration” as an option in the mutual agreement provision (MAP), the expansion of the information exchange provisions, and the addition of an assistance in collection provision. This column focuses on the first of those revisions.

The term “arbitration” is set in quotation marks because this is not, in any real sense, recognizable as arbitration. Just like its OECD counterpart, the new provision in the U.N. model treaty is more like expert determination or, even less adjudicatory in nature, third-party consultation.

This is because the No. 1 feature of arbitration in almost any context other than international tax law is its ability to bind the parties to an outcome after review by an independent panel. Arbitration is meant to be an alternative to judicial determination, but if the parties can reject the arbitration panel’s decision, then it really looks like the panel is merely a means of obtaining outside consultation whose proclamations are in the nature of advice, and not decision. The U.N. model’s provision for arbitration is even more egregious in this regard than that of the OECD, because in the U.N. model the parties who sought and paid for the arbitration themselves (the competent authorities) can undermine the decision of the panel, in addition to the taxpayer. Under the OECD model, only the taxpayer has this unfortunate ability.

One may wonder what purpose arbitration serves if everyone with any interest in achieving an outcome can reject it. Some have argued that the obstacle to fully binding tax arbitration is sovereignty — that deferring to an independent decision-maker would violate some sacred legal space that belongs to the state alone. The U.N. committee wisely rejected this indefensible stance, stating that “sovereignty does not prevent States from agreeing in a tax convention to be bound by the decision of an arbitration board (private tax experts) where their competent authorities cannot reach an agreement on a tax issue.”¹ If that is the case, the decision to allow the competent authorities to undermine the arbitration panel’s decision-making authority seems strange indeed. It is not at all clear how this improves the workings of a tax treaty, whether developing countries are involved or not.

If what countries really want is the ability to consult private tax advisers as part of their competent authority decision-making process, it is not at all obvious as a technical matter why they should not draft a model provision to achieve that and set aside the disingenuous notion that this is about extending or assisting the MAP process with alternate dispute resolution. One could call it expert determination and then people in


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the arbitration field would at least recognize what the international tax people were trying to get at. Better still, one could call it what it is — nonbinding third-party consultation, and leave the arbitration folks out of it altogether.

But it may be more obvious from a sociopolitical perspective why tax treaty model drafters, in the U.N. or otherwise, might not want to admit that this is the real goal. That is because the primary significance of all of this arbitration business is the naming of experts (tax lawyers, accountants, and economists) and the elevation of these private sector individuals to a de facto decision-making position in matters of state-state tax revenue allocations.

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This privatization of international tax lawmaking should make everyone wary, but it should be especially troubling to developing countries, since experts seem all too often to be identified solely in the developed world. The U.N. contemplates this possibility and states that “[i]t is necessary to have experienced independent and impartial arbitrators from developing countries (and countries in transition) to make sure that the position of those countries will be understood by the arbitration board so that the arbitration process will lead to fair results.” At the same time, the committee worries that “[t]he group of experts in international taxation is quite limited and a great number is biased as is demonstrated through their professional activities or their publications.” The committee goes on to suggest that there are ways to try to ensure impartiality, but it seems clear that this is a major worry for developing countries. Yet OECD representatives have taken opportunities at conferences and workshops to laud the availability of tax experts from developed countries as a selling point for arbitration regarding developing countries, as these individuals would otherwise be very expensive to consult on a unilateral basis. Arbitration: a cheap way to get otherwise uninterested tax experts to rally to your cause?

Perhaps, but consider the optics of an expert determination panel composed exclusively or even mostly by developed country experts who are to determine how to allocate taxing rights between a developed and a developing country, using their general knowledge, experience, and opinions about the international consensus on various tax matters. There seems to be a lot of risk and not a lot of control for developing countries in this schematic. Moreover, it virtually ensures the continuing dominance of OECD policy positions in the implementation of tax treaties. This dominance may be more or less welcome depending on one’s perspective on various tax policy matters, but seems particularly problematic given the current divergence of opinion on matters such as transfer pricing — the most prevalent matter to be determined under any form of treaty-based dispute resolution.

These factors demonstrate that the identification of experts matters a great deal. As one arbitration expert put it:

just as “location, location, location” comprise the three key elements in sustainable real estate value, so it has been observed that “arbitrator, arbitrator, arbitrator” endure as the most critical factors in the integrity of any arbitration.2

The determination of the arbitrators is the resolution of the case. That is not to say that experts from developed countries will always and necessarily make decisions that favor developed countries; the opposite could be true, despite the U.N.’s stated fears. But a look at the literature on arbitration in other contexts suggests that there is cause for worry — at the very least, there is cause for being vigilant about the structure that is being adopted for states to allocate revenues cooperatively going forward. This is especially true in cases involving things like transfer pricing in which the disputes are regularly likely to hit the big and hotly contested issues of international tax policy.

According to a surprisingly large number of people in the international tax policy community, none of this should really pose any concern since arbitration in tax treaties is really nothing more than a means to compel the competent authorities to hurry along in their endeavoring to agree. These commentators would have us view arbitration as grease for the wheels of compromise — at most a threat and certainly not a promise. But it would be truly incredible if governments around the world were going through all of the trouble to create a whole new dispute resolution institution without any intention of actually using it. The fact that governments are busy vetting lists of potential arbiters suggests that this is not credible at all.

Rather than picturing tax treaty arbitration provisions as grease for the wheels of compromise, it may be more accurate to picture these provisions in the shape of a large wooden horse. We may do little more than speculate about what the army within seeks to

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accomplish. No doubt, arbitration is a lucrative industry for both the expert arbiters themselves and facilitating institutions such as the International Chamber of Commerce. It is also a delivery system for the product developed by the OECD, the self-described “market leader” in international tax policy (which likely understates the case). There may be many reasons to like the idea of alternative dispute resolution in general, and perhaps especially in the complex and rarefied world of international taxation. But the way tax treaty arbitration is taking shape is troubling to say the least.

The U.N. model arbitration provision is strange in both structure and purpose, and in its strangeness it precisely mirrors the OECD schematic despite some rather cosmetic differences from the OECD model. The U.N. model’s slightly longer period for competent authority dispute resolution (three years as compared to the OECD model’s two), the fact that it is initiated by the competent authorities instead of the taxpayer, and the fact that the competent authorities themselves can agree to back out of the result do not redeem the U.N. provision from this schematic parity. The unresolved institutional and sociopolitical issues that characterize the OECD model are magnified, not mitigated, in the new U.N. model.

It is clear that the U.N. committee is aware of these and related design problems and seeks to keep options open for developing countries, but it is also clear that in bilateral negotiations, developing countries may not be in a position to quibble. The very existence of a model arbitration provision in the U.N. model at all may serve to weaken a country’s negotiating position because it implies acquiescence to a purported consensus about the appropriateness of imposing this structure onto the international tax landscape. Having drawn it on the MAP, it will be difficult to now ignore. And since the decisions of the panel of tax experts will always be confidential, just like the decisions of the competent authorities themselves, there will be no effective way for the broader tax community to monitor the situation as it develops.

There are good reasons to be deeply skeptical of tax treaty arbitration, and the U.N. model’s minor divergences from the OECD model do not address the especially worrisome features inherent for developing countries in this emerging order. Developing countries may well be forgiven if they resist the adoption of tax treaty arbitration — whether mandatory or not — for the foreseeable future.