WHAT CAN THE TAX COMMUNITY LEARN FROM DISPUTE RESOLUTION PROCEDURES IN NON-TAX AGREEMENTS?¹

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What Can the Tax Community Learn from Dispute Resolution Procedures in Non-Tax Agreements?

In this article, the authors examine, from a tax perspective, various types of dispute resolution that are available under a number of non-tax instruments and bodies.

1. Introduction

This article provides an overview of the different types of arbitration that exist under bilateral investment treaties (BITs) (see sections 2 and 3.), the proposed Transatlantic Trade and Investment Partnership (TTIP) (see section 4.), the North American Free Trade Agreement (NAFTA) (see section 5.), social security agreements (see section 6.) and the World Trade Organization (WTO) (see section 7.). In this respect, the article also examines what the tax community can learn from these agreements with regard to tax arbitration, having particular regard to tax treaties (see section 8.). The articles ends with some conclusions (see section 9.).

2. Arbitration under BITs

2.1. Overview

BITs are international agreements between states, providing certain guarantees to foreign investors and ensuring certain standards of treatment. At the end of 2012, 3,200 BITs had been concluded worldwide. Most BITs provide for investor-state arbitration as the dispute settlement mechanism. As a result, when a foreign investor claims that the host state has violated the BIT concluded between

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1. In order to advance this debate, the Institute for Austrian and International Tax Law at the Vienna University of Economics and Business (WU), in partnership with the business community, has initiated a major three-year project on the use of arbitration in tax matters. The first event was a meeting regarding “Mandatory arbitration: an essential feature of international tax arrangements”, held on 19 and 20 January 2015, bringing together the leading experts in this field and presenting the interim results. A book on the findings of this workshop is to be published in the late summer of 2015. Other events in the course of 2015 and 2016 include a conference on the interaction of bilateral investment and tax treaties that was held in Rust, Austria, on 3 and 4 July 2015, a follow-up meeting on arbitration in international tax matters to be held on 12 and 13 October 2015 and a joint WU-International Fiscal Association (IFA) Seminar at the 2016 IFA Congress in Madrid. These initiatives seek to address conceptual and practical issues with a particular focus on the perspective of developing countries.


the host state and the home state of the investor, the investor may take this claim before an international arbitration tribunal.

2.2. Expropriation

BITs include an expropriation provision that permits expropriation to occur only subject to certain conditions. In general, a state may expropriate a property of a foreign investor only for a public purpose, in a non-discriminatory manner, on payment of compensation and with a provision for judicial review. It is accepted that, currently, expropriation occurs predominantly indirectly. This article, therefore, focuses on the determination of indirect expropriation.

2.3. National treatment and most-favoured-nation treatment

The standards regarding national treatment (NT) and most-favoured-nation (MFN) treatment require either contracting state to treat the investors of the other state no less favourably than its own investors or any investors of a third state that are in the same circumstances. The NT and MFN standards require a comparison to be made between national and foreign investors or between national investors and investors of a third state that are in the same circumstances. A comparable hypothetical case must, therefore, be established to make the comparison and determine whether there is a discriminatory measure.

2.4. Fair and equitable treatment

BITs include an obligation of either contracting state to provide fair and equitable treatment (FET) to investors of the other state in their own territory. FET is not defined in BITs, even if it is a significant standard which is quite often cited. In fact, FET remains to be rather a very vague standard. Despite the drawbacks of the absence of a proper definition of the FET standard, no substantial guidance is provided for its application. Furthermore, in essence, there is no consensus in the doctrine or jurisprudence on the nature of FET. While one side of the argument claims that FET does not introduce a more comprehensive protection to the foreign investor than the protection offered by customary international law, the other states the FET

provides an additional layer of protection that is beyond the limits of customary international law and, therefore, autonomous.5

2.5. Capital transfers

Both the investor and the host state of the investor have an interest in the repatriation of investment profits and are willing to secure the right to repatriate. On the other hand, repatriation may be considered to be harmful by host states, which prefer that the profits are reinvested in their economy. The capital transfer provisions try to balance this conflict of interests between the investor and the host state.

3. Dispute Resolution under BITs: Investor-State Dispute Settlement

3.1. Introductory remarks

In the event of a violation of an obligation regarding a qualifying investment in the territory of one of the contracting states by a qualified investor from the other contracting state, the protection offered by a BIT may be invoked. Generally, investment is broadly defined in the BITs and also broadly interpreted in case law.

Natural persons qualify as investors under BITs if they hold the nationality of one of the contracting states. With regard to legal entities or partnerships, several criteria apply, for example, place of incorporation or place of management. Some treaties contain a denial of benefits clause that is designed to deny treaty protection to certain persons, such as shell or mailbox companies, which do not carry on substantial activities in the host state.6 Notably, tribunals have taken a quite formal approach to treaty shopping practices in investment disputes.7

BITs provide the investor with the right to directly enforce its rights before an arbitral tribunal. The body appointing the arbitral tribunal, in many cases the International Centre for the Settlement of Investment Disputes (ICSID), is stated in the BIT. An investor has the opportunity to submit its dispute with the host state directly to an arbitral tribunal. In order to make such a submission, the investor is not required to obtain the consent of any of the contracting states. In addition, the arbitral award is binding on both the host state and the investor.8

3.2. Tax consultation and/or tax veto

Some BITs contain a provision requiring the investor to refer its complaint of expropriatory taxation to the tax authorities prior to, or at the time of, initiating the arbitration process. If a BIT includes such a provision, the tax authorities take a joint position that constitutes a recom-

mendation or a binding final decision. Such provisions have a significant power to prevent an issue from being discussed by an arbitral tribunal and have been criticized, given their restrictive nature.9

3.3. Increasing number of disputes

The number of investment disputes continues to rise. Currently, 195 cases are pending before tribunals formed by the ICSID.10 Notably, in 2013, at least 57 known investor-state dispute settlement cases were initiated under investment agreements. Although the cases brought from developed countries constitute the majority with 45, a number of cases were brought from developing countries as well. Significantly, in 75% of all cases, the claimants are from either the European Union or the United States.11 Almost 40 cases involve taxation.

3.4. No precedent rule

Tribunals are not bound by previous awards. This issue has been confirmed by many tribunals over the years. However, it has been asserted that a de facto precedent exists. As a result, when tribunals have to decide cases, they apply the previous awards rendered in cases with similar facts.12 In addition, even though BITs are products of negotiations and, therefore, may differ to some extent, common grounds exist between BITs. Consequently, it has been observed that, in practice, previous awards are cited frequently.

3.5. Forums for dispute settlement

ICSID and UN Commission on International Trade Law (UNCITRAL) rules are the most common options found in BITs. The ICSID Convention is only available for cases where both the home state and host state of the foreign investor are parties to the ICSID Convention.13 If either the home state or the host state is not a party to the ICSID Convention, it cannot be applied, in which case the ICSID serves as an administrative institution for the proceedings. The major significance in the choice of forum is that, with regard to the ICSID Convention, awards cannot be challenged in domestic courts, whereas under the ICSID and UNCITRAL facility rules this possibility remains.14

3.6. Costs

Investment arbitration costs are quite high. Costs and expenses may be divided into the following three categories: (1) arbitration costs consisting of the fees of arbitrators.

5. For further discussion on the different conceptions of FET, see Salacuse, supra n. 3, at p. 222.
6. UNCTAD, supra n. 2, at p. 53.
11. These numbers are taken from UNCTAD, Recent Developments in Investor-State Dispute Settlement, IA Issues Note, N.1 (Apr. 2014).
13. Art. 25(1) ICSID Convention.
and applicable secretariat costs; (2) legal fees; and (3) additional costs for experts, witnesses and hearings. Legal fees average about 82% of the total costs of a case. The legal and arbitration costs of an investment arbitration case average around USD 8 million, in some cases reaching USD 30 million. Some reforms have been sought for a reduction in costs, but their effectiveness is yet to be observed. The most frequent approach to cost allocation has been that each party bears its own costs, while there is a trend towards more reasoning in cost allocation decisions.\footnote{16}

4. Dispute Settlements under the TTIP

4.1. The TTIP

The TTIP is the new agreement on free trade negotiated between the European Union and the United States. Its primary purpose is to facilitate economic growth\footnote{17} and higher living standards, which may be attained through reducing barriers to transatlantic commerce.\footnote{18} The negotiations commenced in June 2013.

The TTIP will be based on the following three pillars:
(1) market access, i.e. customs duties and restrictions on services should be removed;
(2) regulatory coherence and cooperation in removing regulatory barriers; and
(3) cooperation in setting international standards.

The inherent element of boosting cross-border trade is ensuring a predictable environment where foreign investments are treated fairly and are not discriminated against compared to domestic firms. In order to attain this objective, both special investment protection provisions guaranteeing the rights of traders and investor-to-state dispute settlement (ISDS) are to be provided for in the TTIP. The essence of ISDS is to enforce the protection provided. Under ISDS, investors will be able to bring claims against the authorities of their host state before an international tribunal. Whereas investment protection provisions limit the scope of potential dispute, ISDS provisions will refer to the way in which they can be effectively enforced in case of their breach.

Taking into account some considerations with respect to the possibility of introducing arbitration into international taxation, it is relevant to focus on the prospective provisions of investment protection and ISDS with regard to the TTIP. What makes the TTIP so appealing is that it will attempt to combine different experiences in the field of international arbitration so that the balance between protecting investors and safeguarding the rights of host states with regard to public regulations will be retained.

As the draft of the provisions regulating ISDS under the TTIP does not exist yet, the basis for this article has been the online questionnaire for public consultation on investment protection and ISDS,\footnote{19} and the concept paper presented by the Commission on 6 May 2015 (the “concept paper”).\footnote{20} In these documents, most of the concepts referring to improvements to ISDS are exemplified by the draft Comprehensive Trade and Economic Agreement negotiated between the European Union and Canada (the “CETA draft”).

4.2. The search for the balance of interests in ISDS

4.2.1. Opening comments

The ISDS provisions in the proposed TTIP have already been subject to a public debate with a number of countries, including Germany, which are very strong in their opposition to any investor–state arbitration provisions, and others, including the United Kingdom and the United States, being determined that the agreement must have such provisions. Over the next 12 months, a vigorous debate is likely to be held on the current proposals.

So far, the public consultation has provided three of the most controversial issues.\footnote{21} The first refers to the legitimate right of governments to regulate in the public interest. This is going to be dealt with primarily by explicit acknowledgment of the right to regulate and the clarification and limitation of the rights investors are granted. The second concerns the fact that ISDS proceedings are held in secret, such that they can be regarded as being biased and containing conflicts of interests. As a result, under the TTIP, full transparency as well as impartiality and the ethical conduct of arbitrators will be ensured. The final, but not least, argument reflects concerns as to inconsistent and biased practice in ISDS. The EU response to this is the appellate mechanism. All of the planned solutions that are to be introduced under the TTIP are, therefore, described subsequently.

From the perspective of arbitration in taxation, it should be emphasized how the European Union is striving to protect and regulate rights of host states under the TTIP. In considering the problem of privileged foreign investors, the Commission has adopted a two-pronged approach. On the one hand, the substantive basis for the dispute will have to be precisely clarified and delimited, and, on the other, significant improvements on the sole proceedings will be brought about.

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\footnote{15} Id., at p. 145.


\footnote{17} According to an official statement from the Office of the US Trade Representatives on 16 November 2014, negotiations on the TTIP are intended “to build upon the strong foundation of our six decades of economic partnership to promote stronger, sustainable and balanced growth, to support the creation of more jobs on both sides of the Atlantic and to increase our international competitiveness”. The statement is available at https://ustr.gov/about-us/press-office/press-releases/2014/November/Statement-on-the-Transatlantic-Trade-and-Investment-Partnership.


\footnote{20} See the Commission’s concept paper, Investment in TTIP and beyond – the path for reform, available at http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF.

4.2.2. Substantive provisions

4.2.2.1. The scope of investments under protection

In order to avoid abuse of ISDS, the European Union intends to limit the subjective scope of investment protection. Three steps are planned to attain this objective. First, “shell” and “mailbox” companies are supposed to be excluded from the scope of protection provisions. Only substantial business activities within the territory of the European Union or the United States will be granted protection. Second, investments should have been made in accordance with applicable law. If an investor does not respect the law of the host state when making the investment, it will not be granted protection. The third requirement is commitment of substantial resource in the host state. The investments that are only planned will fall outside the scope of protection.

4.2.2.2. Protected rights of foreign investors

The investment protection granted under TTIP and enforced through ISDS will be based on three principles. They are: (1) non-discrimination; (2) FET; and (3) guarantees against expropriation. In order to eliminate any uncertainty in the interpretation of these standards, they will be clarified.

With reference to the non-discriminatory provision, different standards are planned to be provided for established investors and investors that are planning to enter the market of a particular host state. Although non-discriminatory treatment will be ensured in the form of the NT clause, in rare cases discrimination against existing investments in selected sectors may be allowed, and, with reference to the right of establishment, a decision as to whether opening in certain markets must be taken. The provision providing for MFN treatment will be limited extensively, so that the “importation of standards” will not occur. In order to limit the scope of the non-discriminatory provisions, the TTIP will include carve-outs, so that parties to the agreement will be free to adopt any kind of measures relating to the relevant sectors, i.e. the protection of health, the environment and audio-visual matters.

The requirement to grant foreign investors FET will also be clarified and limited. Its application will be based on the breach of a limited set of basic rights as stated in the TTIP. These rights will include the denial of justice, the disregard of the fundamental principles of due process, manifest arbitrariness, targeted discrimination based on gender, race or religious belief, and abusive treatment, i.e. coercion, duress and harassment. The list may be extended subject to agreed consent of parties to the TTIP. What is more, the “stabilization obligation” will be excluded from the scope of FET. Investors will be able to recall their legitimate expectations only on clear and specific representations on making or maintaining the investment that were made by the party, relied on and not subsequently respected.

At the core of any international investment agreement, guarantees against direct and indirect expropriation are envisaged. This aspect of investment protection will also be limited to ensure that claims against legitimate public policy measures cannot be made. Specific areas of public policy will be carved out from the scope of expropriation, for example, the environment and health. This action is primarily targeted at indirect expropriation, which, in principle, cannot restrict host states with regard to their policy, unless it is manifestly excessive.

4.2.2.3. Protected rights of the host state

The right of the parties to regulate will be confirmed as a principle in the TTIP. It is proposed to state expressly the right of governments to take measures to achieve legitimate public policy objectives, on the basis of the level of protection that they deem to be appropriate. The further amplification of that principle will be carve-outs and other exceptions, for example in a situation of crisis, which will enable host states to undertake special policy measures subject to conditions or in sectors stipulated in the TTIP. This will include safeguarding measures that will be applied in cases involving serious monetary or exchange rate difficulties. The scope of the proposed provisions may be expanded, subject to the consent of the parties of the TTIP. It has also been proposed that the application of domestic law should not fall under the competence of ISDS tribunals. ISDS tribunals should be allowed to take into account domestic law only as a factual matter, whereas any interpretations of domestic law made by ISDS tribunals will not be binding on domestic courts.

4.3. Procedural provisions

Most of the ISDS tribunals that are appointed under international agreements work on the basis of an existing procedural framework, which is offered by the ICSID (a World Bank body) or by the United Nations Commission for International Trade Law (UNCITRAL). Substantial disadvantages regarding existing procedural rules have appeared in recent years. In the TTIP, special solutions will be provided.

First, the process of resolution of disputes under ISDS will be transparent. In order to ensure this, the UN rules on transparency22 will be incorporated into the TTIP. These special provisions require the publication of information at the commencement of arbitral proceedings, i.e. the names of parties to the dispute, the economic sector in which the investor is active and the treaty challenged, the publication of arbitral documents, submissions by third parties and non-disputing parties to the treaty (these can even be invited), and official hearings. Nevertheless, transparency under the UN rules on transparency is restricted by a few exceptions that refer, inter alia, to confidential business information or information protected under the law of either respondent state or any law determined by arbitral tribunal. These provisions do not, however, permit making the proceedings confidential completely. Only some time limits, designation or redaction of some information and

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holding hearings in private may be applied. The exception is the risk of jeopardizing the arbitral process. But even then, the available measures are limited to restraining or delaying the publication of information.

Second, the European Union wishes to favour domestic courts and mediation under the TTIP. This is why the relevant time limits will be prolonged if investors go to a domestic court or pursue mediation. In the case of mediation, it could be possible at any time. In comparison to the text of the CETA draft that was published on 26 September 2014, this agreement includes elaborated recommendations for consultation and mediation that may be agreed at any time, including after arbitration has commenced.\(^{23}\)

In addition, under the TTIP, parallel claims will be excluded. In this way, the European Union wishes to avoid over-compensation and ensure consistency. Claims on the same matter at the same time before an ISDS tribunal and domestic courts will not be allowed. The commencement of ISDS proceedings could depend on either a definitive choice between ISDS and domestic courts at the very beginning of any legal proceedings or a declaration by the investor of waiving its rights to initiate any proceedings before a tribunal or a court with regard to any measure alleged before an ISDS tribunal. If a claim existed before a court, it would have to be withdrawn to commence ISDS proceedings. With reference to companies affiliated with the investor, such companies will not be able to make a claim effectively if the claim has been brought by the investor. That is why the ISDS tribunal will have to take into account any relevant or related cases that may contribute to overlapping compensation or might have a significant effect on the case.

Furthermore, special attention will be paid to arbitrators, i.e. to their ethics, conduct and qualifications. As the independence and impartiality of arbitrators acting within ISDS will be of great concern, specific requirements, including a code of conduct, will be introduced. There will be special procedures to identify and deal with any conflicts of interests, for example, the possibility of removal of the arbitrator by way of challenge proceedings. Even if the award has already been granted, the parties to the dispute will be able to request a reversal of that. With reference to the qualifications of ISDS arbitrators, detailed requirements will be set out. These will include independence, impartiality, expertise in international law and international investment law, and experience in international trade law and international dispute resolution. The European Union is considering establishing a roster of qualified TTIP arbitrators. In the concept paper, the idea of a roster was further developed. It was proposed that parties should be required to choose arbitrators only from a pre-established roster. This should help to avoid conflicts of interest and, therefore, concerns that arbitrators are not acting with full impartiality.

In the new ISDS provisions under the TTIP, the European Union also wants to reduce the risk of frivolous and unfounded cases. This will be dealt with in a number of ways. First, all claims will fall under the interim filtering mechanism for frivolous claims. Claims without legal merit or legally unfounded will be dismissed. Although, in principle, this will be decided by an ISDS tribunal in the preliminary proceedings, any such objection may be raised at any appropriate time. What is more, the risk of frivolous and unfounded cases will be reduced by shifting the burden of all costs of the proceedings to the losing party. Some exceptional circumstances may be taken into consideration by a tribunal.

Another innovation that the European Union would like to introduce into ISDS under the TTIP is the possibility of discontinuation of proceedings before a tribunal on a joint determination of a special body on the validity of defence to the claim. The validity of defence to the claim should be decided on with reference to carve-outs stated in the TTIP. The primary objective behind this is the intention of the European Union that investors will not challenge measures adopted so as to maintain the overall stability and integrity of the financial system, especially when financial crises arise.

To ensure uniformity and predictability in interpreting the TTIP, certain interpretative measures will be taken. The European Union intends to introduce interpretation interventions. This would be granted only to the parties to the TTIP, i.e. the European Union and the United States, which would be allowed, in any case, to explain to the arbitrators how the relevant provisions of the TTIP should be construed. In the case of agreement of both parties regarding certain interpretation, the ISDS tribunal would have to respect it. The position of parties in respect of interpretation of the TTIP would also be strengthened by the possibility of delivering binding interpretations on issues of law.

A significant departure from the previous practice of ISDS tribunals will be an appellate mechanism planned by the European Union. As in existing international frameworks, the awards of ISDS tribunals will be final, with the exception of very limited procedural grounds. Even on these exceptional cases, ISDS rulings could be only annulled, but never revised. From the perspective of the European Union, the mechanism is necessary to increase the legitimacy of the system and ensure uniformity of interpretation. This could ensure the possibility of correcting ISDS errors. A similar proposal, which was introduced into the CETA draft, is more restrictive. Under the CETA draft, structuring an appellate mechanism remains an alternative that should be looked into. In the concept paper, the idea of an appellate mechanism was expanded. It was proposed to adopt the model existing in the institutional set-up of the WTO Appellate Body with some modification. The WTO Appellate Body could consist of seven permanent members, two from each party and three non-nationals, whose qualifications would be broadly similar to those of other members of the WTO Appellate Body and/or the International Court of Justice (ICJ).

However, it is the idea of a permanent court that appears to be the most significant novelty in comparison to the existing practice of ISDS tribunals. It has been suggested

that this permanent court be formed as a self-standing international body or be embedded into an existing international organization. It would apply to bilateral agreements and between different trading partners. It could also be based on an opt-in system. Currently, no further details are available.

5. The NAFTA

5.1. Introductory remarks

The NAFTA was concluded by Canada, Mexico and the United States with the objective of promoting opportunities for investment as well as providing a suitable investor protection mechanism.24

5.2. Investor protection

Chapter 11 of the NAFTA contains protective clauses enabling a party to force a foreign government to undergo international arbitral proceedings under the rules of ICSID or UNCITRAL,25 or enabling an investor to bring a claim to an international tribunal, thereby circumventing the domestic courts of the host state26 and requiring that the applicable law should be that of the NAFTA, as interpreted and applied under international law.27 Bringing a claim under chapter 11 of the NAFTA is advantageous, as it reduces the cost of litigation and the possibility of a jury that would be sensitive to the needs of the host nation,28 allows each party to appoint its own arbitrator to present its position, and provides for the application of international law, and not domestic law, to the dispute in question. Chapter 11 of the NAFTA also allows persons to sue national governments.29

Chapter 11 of the NAFTA has been a subject of some controversy, especially with regard to the provisions surrounding expropriation and investor-state dispute settlement mechanisms, which have arisen in respect of several sovereign and regulatory matters.30 The NAFTA enables foreign investors to bring an action against the government of a Member State, whereas, due to sovereign immunity, such rights are not extended to domestic investors. Foreign investors also have a right of action over claims that are not available to domestic investors.31

5.3. Investor protection in action

A case which highlights the overtly pro-foreign investor stance of chapter 11 of the NAFTA is Loewen Group v. The United States.32

25. Id. at art. 1120(1).
26. Id. at art. 1121.
27. Id. at art. 1131(1).
29. Id. at pt. 123.
30. Article 1110(1) of the NAFTA states that no party signatory may nationalize or expropriate an investor’s assets, except for public purpose, on a non-discriminatory basis, in accordance with the due process of domestic as well as international law and on payment of compensation.

33. The tribunal found that the trial judge had failed in his duty of taking control of the trial by allowing the jury to be exposed to constant appeals to prejudice on the part of the claimant’s counsel and witnesses and termed the trial as a ‘disgrace’. See J. Dhoge, The Loewen Group v. United States: Punitive Damages and the Foreign Investment Provisions of the North American Free Trade Agreement 19 Conn. Int. L., pp. 495 and 498-499 (2004).
34. Treaty on the Functioning of the European Union (TFEU), OJ C 115 (2008), EU Law IBFD.
7. Dispute Settlement and the WTO

7.1. Overview of the dispute settlement procedure in the WTO

The current dispute settlement procedure of the WTO was adopted as a result of the Uruguay Round in 1994 and is implemented in Annex 2, “Dispute Settlement Understanding” (“DSU”) of the Agreement Establishing the WTO. It replaced the then existing dispute settlement procedure under the General Agreement on Tariffs and Trade (GATT) of 1947, which had many disadvantages, the first and foremost being the requirement for consensus in the implementation of decisions, which prevented the effective conclusion of disputes.

The dispute settlement procedure prevents WTO member countries from implementing unilateral measures in the event that another member country has introduced contentious trade policy measures. Some have argued that the dispute mechanism resembles the functions of a court or tribunal, as it is a multilateral institution with an effective control, operating within a predetermined time frame and issuing automatically adopted rulings.

The WTO argues that dispute settlement is the central pillar of the multilateral trading system and contributes significantly towards the stability of the global economy, i.e.:

[without a means of settling disputes, the rules-based system would be less effective because the rules could not be enforced. The WTO's procedure underscores the rule of law, and it makes the trading system more secure and predictable. The system is based on clearly-defined rules, with timetables for completing a case.]

In particular, article 3(7) of the DSU states that:

... The aim of the dispute settlement mechanism is to secure a positive solution to a dispute. A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred.

Accordingly, the member countries must first enter into consultations under article 4 of the DSU before resorting to further action. If the matter cannot be settled in this way within 60 days or if the parties agree that the consultations have failed, they may request a Panel (see section 7.3.). Alternatively, the parties may volunteer to use other measures, such as good offices, conciliation or mediation. Such measures may be requested at any time by any party to a dispute and terminated at any time, meaning that they may also proceed during the Panel process.

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38. Art. 11(1) Regulation.
39. The predecessor Regulation (EEC) No. 1408/71 contains a few exceptions where simultaneous application of the legislation of more than one Member State had been possible, for example, under article 14c.
40. Art. 11(3)(a) Regulation, i.e. lex loci laboris.
41. Sometimes referred to as a "posting certificate", although other aspects of the applicable legislation are also covered by that standardized form under Regulation No. 1408/71: form E 101.
42. Treaty on the European Union (TEU), OJ C 115 (2008), EU Law IBFD.
44. The Round was concluded on 15 April 1994 by the Marrakesh Declaration, signed by the Ministers.
47. Id., at p. 496, with further references.
49. Art. 4(5) DSU.
50. Id., at art. 4(7).
51. Id., at art. 5.
7.2. The Dispute Settlement Body
The Dispute Settlement Body (the “DSB”) is the administrator of the rules and procedures under the DSU. The DSB consists of representatives of all WTO member countries and has the sole authority to establish Panels, adopt Panel and Appellate Body reports, monitor the implementation of rulings and recommendations and authorize retaliation when a member country does not comply with a ruling.52

7.3. The Panel
The Panel is the first instance of dispute settlement and is established by the DSB at the written request of the complaining party. The duty of the Panel is:

[to examine, in the light of the relevant provisions in (name of the covered agreement(s) cited by the parties to the dispute), the matter referred to the DSB by (name of party) in document... and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in that/ those agreement(s)].53

The function of the Panel is to assist the DSB by assessing the case objectively. The Panel submits a written report detailing the findings of fact, the application of the relevant provisions and the rationale behind its findings and recommendations to the DSB.54

Panels are composed of three or five Panelists, the latter at the request of both parties. The Panelists are selected based on nominations proposed by the Secretariat to the parties. The parties may oppose the proposed candidates, but they require compelling reasons to do so. If there is no agreement on the Panel members, the composition of the Panel should be decided by the Director-General in consultation with the Chairman of the DSB and the Chairman of the relevant Council and/or Committee.55

In order to assist in the selection of Panelists, the Secretariat maintains a list of qualified governmental and non-governmental representatives from which the Panelists can be drawn as appropriate. The list includes persons who have served on a case before a Panel, represented a member country, served in the Secretariat, taught or published on international trade law or policy, or served as a senior trade policy official of a member country. Member countries may suggest the names of governmental and non-governmental representatives to be added to the list upon approval by the DSB.56

The selection of Panel members is intended to ensure independence, a diverse background and a wide spectrum of experience. As a result, citizens of parties to the dispute may not serve, unless both parties agree. Member countries are not allowed to give instructions to the Panel members or influence them in any way. The Panel must also include at least one member from a developing country if a party that is itself a developing country so requests.57

The proceedings before the Panel may generally not exceed six months, the absolute limit being nine months. At the beginning of the proceedings, the parties deposit their written submissions.58 Thereafter, the Panel may seek information59 and must consider the rebuttal submissions and oral arguments of the parties. The preliminary conclusions are submitted for consideration to the parties in the form of an interim report detailing the facts and arguments. The report is reviewed and edited, with the comments of the parties being included in the final report, which is circulated to all member countries.60

The Panel’s report is then considered by the DSB and must be adopted within 60 days of its circulation, unless a party formally notifies the DSB that it will appeal the report or the DSB decides by consensus61 not to adopt it.62

7.4. The Appellate Body
As opposed to the Panel, the Appellate Body is a standing body that is established by the DSB and is composed of seven persons, three of which serve on each case. The Appellate Body consists of:

persons of recognized authority, with demonstrated expertise in law, international trade and the subject matter of the covered agreements generally.

They must be unaffiliated with any government and broadly representative of membership in the WTO. If there is a direct or indirect conflict of interest, they are not allowed to participate in the dispute. The members serve a four–year term and may only be reappointed once.63

The appeal is limited to issues of law and legal interpretation and may only be filed by a party to the dispute. The Appellate Body must draw up its report within 60 days64 after the formal notification of the appeal. It is important to note that the findings and conclusions of the Panel may be upheld, modified or reversed. The report is then adopted by the DSB and accepted unconditionally by the parties. The DSB itself may deviate from the report if there is consensus among the member countries.65

7.5. Adopting and enforcing decisions
The dispute resolution process is designed to enforce adherence to the WTO agreements. The principle that “agreements must be kept”66 is not just an aspirational objective, but it is an ironclad rule.67 The objective of the dispute settlement mechanism is to reach a consensus, if possible by means of consultation. In the event that cons-
sultation fails, article 3(7) of the DSU lists the hierarchy of other measures to be taken:

... In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements. The provision of compensation should be resorted to only if the immediate withdrawal of the measure is impracticable and as a temporary measure pending the withdrawal of the measure which is inconsistent with a covered agreement. The last resort which this Understanding provides to the Member invoking the dispute settlement procedures is the possibility of suspending the application of concessions or other obligations under the covered agreements on a discriminatory basis vis-à-vis the other Member, subject to authorization by the DSB of such measures.

In keeping with these precepts, if the Panel or Appellate Body concludes that a measure is inconsistent with a given agreement, it recommends that the measure be brought in conformity with it.68 The DSB is then responsible for overseeing the implementation of the recommendations. Thirty days after the decision has been adopted, the member country must inform the DSB of how it intends to implement the recommendations and state a reasonable period of time for doing so.69 If the ruling is not applied within a reasonable period of time, temporary measures, such as compensation and suspension of concessions, may be adopted as a last resort. Their use is subject to restrictions: compensation is voluntary and there are detailed guidelines concerning suspension of concessions. Most importantly, these measures must first be authorized by the DSB.70

7.6. Arbitration under the DSU

The DSU provides for several types of arbitration procedures. Two of these concern disputes arising in connection with the enforcement of DSB rulings. The most frequently used arbitration procedure within the DSU concerns the first level of the enforcement procedure, i.e. the determination of a reasonable period of time for the implementation of the ruling if the parties fail to reach an agreement therein.71 Arbitration is also used in the third stage of enforcement to determine whether the complainant party has observed the relevant principles with regard to the application of trade sanctions.72

Arbitration is among the alternative means of dispute resolution that WTO member countries may resort to under the DSU.73 The use of arbitration is subject to mutual agreement of the parties on the procedural rules. This agreement is notified to the other member countries, which may then become parties to the proceedings. All of the parties to the proceedings must agree to abide by the arbitral award. The DSB is informed of the award and oversees its effective implementation. This provision is intended to emphasize the fact that the arbitral award cannot affect the rights and obligations of other WTO member countries or prevent different interpretations of the WTO rules by the Panels and Appellate Bodies.74 Despite the fact that arbitration is considered to be a quick, efficient and economic means of dispute resolution, to date, article 25 of the DSU has only been used once.75 Malkawi (2007) argues that this is due to the limitations of article 25 of the DSU, which excludes arbitration by the International Chamber of Commerce or UNCITRAL. The provision is very vague and uncertain. For instance, no procedural rules are included. As this requires the agreement of the parties, it is difficult to achieve.76

8. What Can the Tax Community Learn from the Experience of Arbitration in Non-Tax Agreements

8.1. Introductory remarks

In this section, the procedures described in sections 2 to 7 are related to treaty law. In sections 8.1 to 8.5, the authors point out certain options or ideas which may be worth considering. Nevertheless, it should be remembered that these procedures are very different in nature compared to dispute resolution under tax treaties. For instance, while a mutual agreement procedure (MAP) and arbitration under tax treaties are state-to-state processes, under BITs, arbitration takes place between the investor and the host state. In the same vein, even though it takes place between two states, the dispute resolution process within the WTO is institutionalized and the decision is enforceable. As a result, an extrapolation of their characteristics to the tax world should only be undertaken with due care.

Consequently, what lessons can be drawn from looking at the many years of experience gained from arbitration in non-tax agreements?

8.2. BITs

One of the most commonly disputed aspects of investment arbitration is the high cost. This may also be an issue to be addressed in tax treaty arbitration. One solution would be to develop simpler mechanisms which incur lower costs. The issue also arises with regard to the choice of party to bear the costs. In BIT arbitration cases, more often than not, each party bears its own costs, whereas in private law arbitration the losing party also bears the costs of the winner. In the case of tax disputes, determining which may be the losing party could be quite challenging.

Arbitral awards do not constitute jurisprudence, but they do provide a solution for a specific case. This is an inherent feature of arbitration, although it could be extinguished by improving transparency and accessibility of arbitral awards to foster the development of international best tax

68. Art. 19 DSU
69. Id., at art. 21.
70. Id., at art. 22.
72. Id., at art. 22(6). See also Pate, supra n. 71.
73. Id., at art. 25.
74. See Pate and Monroy, p. 587, both in Herdin-Winter & Hofbauer eds., supra n. 46.
75. See B.H. Malkawi – Arbitration and the World Trade Organization, 241 Intl. Arb. 2, p. 182 (2007), for a dispute between the European Union and the United States regarding the amount of nullification caused by a US regime that was found not to be a genuine alternative to normal DSU procedures.
76. Id., at p.183.
practices. This conflicts with secrecy requirements, which may require special attention in the tax area.

Developing a set of rules for the procedural aspects of arbitration will certainly be critical. Investment arbitration practice demonstrates that the rules of arbitration may differ to a certain extent and such differences may have a strong effect on the mechanism as a whole. One example of this is clearly the difference between the ICSID rules and the UNCTAR rules on the finality of the awards, i.e. the availability of annulment and challenge procedures. Such aspects could also require a certain level of attention in tax treaty arbitration.

In the arbitration of investment disputes, treaty shopping practices have been approached from a formal perspective. The denial of benefits clauses have been subject to certain conditions. In this respect, the results of the OECD Base Erosion and Profit Shifting (BEPS) initiative\(^7\) may have to be taken into account.

### 8.3. The TTIP

A close examination of the TTIP indicates some interesting new ideas that could be of interest for dispute settlements under tax treaties. Particular attention should be paid to transparency as a feature of procedures under the TTIP. The important issue is that transparency is not treated as absolute but is rather subject to some limitation in respect of business information or trade secrets. This could be the case for a MAP, which currently is a wholly confidential process. Transparency might help to accelerate proceedings and influence interpretations of treaty provisions for future cases. Its limitations with reference to certain types of information would have to be accepted by taxpayers.

Under the TTIP procedure, some interesting solutions could also be relevant for taxation purposes. Already in the initial phase of proceedings under the TTIP, a special mechanism that is intended to limit frivolous claims is provided for. In comparison to tax treaties, it is a competent authority that decides on admissibility to refer the case to a MAP. This sometimes raises doubts as to whether this ability is used as a blocking method for arbitration.\(^8\) Under the TTIP, the justifiable grounds for deciding the case are assessed by an ISDS tribunal that is an impartial body. With reference to dispute settlements in the field of international taxation, it could be questioned as to whether it would be possible to empower institutions other than competent authorities, as these are not always interested in resolving a case or could even have incentives to avoid possible arbitration in the future.

From the perspective of tax sovereignty, which is often raised as a source of objection to arbitration in international taxation, interpretation interventions could also be beneficial. These would enable the contracting states to a particular tax treaty to present how certain provisions should be construed and especially what intentions lay behind them. At the same time, they would help to avoid misinterpretation by an arbitral tribunal.

### 8.4. The WTO

The Box summarizes some of the features of WTO arbitration, which are most relevant in the tax area.

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**BOX: The Advantages of WTO Procedures Compared to Double Taxation Treaties**

#### Time Frame

The WTO dispute settlement mechanism was designed to provide a quick resolution. This is underscored by Article 20 of the DSU, which sets the time frame for the process. The adoption of a report by the DSB should not take more than nine months if the case is not appealed and 12 months if the case is appealed. Appeals are a particularly good example, as they are not allowed to exceed 90 days. There are also special provisions that are intended to speed up consultations and the Panel process in cases of urgency. As a result, the WTO dispute settlement only takes half the time allotted for the MAP under the OECD Model,\(^9\) i.e. two years, and a third of the time allotted pursuant to the UN Model,\(^10\) until arbitration can be requested. As the OECD MAP statistics reveal, MAPs can be even slower in practice.

#### Composition of Panels and the Appellate Body

The DSU places great emphasis on the impartiality of the adjudicators. Both Panel members and the members of the Appellate Body must be independent. The independence of the Panel and Appellate Body is also guaranteed by the fact that the members are not selected by the parties to the case, but by WTO bodies. In the case of the panel, the Secretariat selects three or five members on an ad hoc basis, based on their qualifications from a pre-vetted group, which includes individuals from every WTO member country with backgrounds in academia, government or private practice. The Appellate Body is appointed by the DSB and consists of “persons of recognized authority, with demonstrated expertise in law, international trade” and the WTO agreements.

The composition of these bodies is also very diverse, due to the requirement that the members must be “broadly representative of membership in the WTO” (in the case of the Appellate Body) and have “a sufficiently diverse background and a wide spectrum of experience”, in the case of the Panel. The diversity of the Panel is also ensured by giving developing countries the opportunity to request that at least one Member of the Panel is from a developing country.

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\(^7\) See, for example, OECD, *Action Plan on Base Erosion and Profit Shifting*, p. 13 (OECD 2013), International Organizations Documentation IBFD.


\(^9\) OECD Model Tax Convention on Income and on Capital (15 July 2014), Models IBFD.

\(^10\) UN Model Tax Convention on Income and on Capital (1 Jan. 2011), Models IBFD.
The selection and composition of the Panel and Appellate Body under the DSU addresses several of the perceived drawbacks for arbitration. Not only is the independence of the members safeguarded, but also the difficulty of finding qualified individuals is removed by pre-selection and pre-vetting, respectively. As the parties do not choose their own members, the imbalance of powers between different countries is also mitigated. The concerns of developing countries in this are also explicitly addressed.

**Costs**

One of the most important reasons for the reluctance of developing countries to introduce arbitration in their tax treaties is the fear that they will not be able to bear its costs, which may exceed those of domestic litigation and of which they would have to pay half.

The DSU addresses the issue of economic disparities between the Members by stipulating that the expenses for panelists and members of the Appellate Body, including travel and subsistence allowances are to be met from the WTO budget.

**Binding Nature of the Proceedings and Enforceability**

It is important to note that the dispute settlement process is mandatory in the sense that the WTO member country which adopted the allegedly inconsistent measure cannot prevent the creation of the Panel. It can prevent this once, but this only postpones the proceedings. As a result, member countries cannot block a ruling. In this respect, Ernck (2014) notes that:

one side of the controversy generally has the right to bring it in to the dispute settlement process, unlike the process under our income tax treaties, where one side of the controversy can generally keep it out of the Competent Authority process by alleging that it is not within the scope of the Mutual Agreement Procedure article.81

However, the most important aspect is the fact that the DSB can ensure compliance with its ruling. Member countries are given a reasonable period of time to correct their approach. If they fail to do so, they are ordered to enter negotiations with the complainant concerning the appropriate compensation. Finally, if they cannot reach an agreement, the wronged party can request permission to “retaliate” by banning imports, raising import duties, etc.

For the most part, such a strong enforcement is impossible in the context of tax disputes. The competent authorities are not forced to come to an agreement during a MAP and the taxpayer can, in any case, reject the agreement. In addition, even where arbitration clauses have been introduced into tax treaties, they are to a large extent voluntary.

The most important advantages of the WTO dispute settlement mechanism concern the duration of the procedures and the costs. The mechanism is designed to ensure efficiency and only takes half the time allotted for the MAP, not to mention the additional duration of arbitration. Arbitration is, by its nature, a costly undertaking for all parties involved. The fees of both arbitrators and lawyers tend to be very high and, in addition to these, costs are incurred due to the location of the proceedings, which results in travel and lodging costs for arbitrators, lawyers and the representatives of the competent authorities. This issue is mitigated in the WTO, as the expenses for the arbitrators are met from the WTO budget.

Additional advantages concern the selection of arbitrators and the possibility to appeal the ruling. In the WTO, they are selected by WTO bodies from a pre-vetted group instead of the parties to the dispute, resulting in more diverse and more impartial Panels. The DSU grants member countries the right to appeal Panel rulings. The final decision is then taken by the Appellate Body. However, the fact that the DSB can ensure compliance with its ruling is, in the authors’ opinion, due to the institutional context of the dispute settlement in the WTO and could, therefore, not be replicated in a two-country setting.

In other areas, the dispute settlement mechanism is just as unappealing as arbitration or even has disadvantages. For instance, the participation of the taxpayer, or, in WTO cases, the nationals of both member countries involved in the dispute, is even more limited in the context of the WTO, as the proceedings can only commence at the request of one of the member countries and other parties may at most attend the proceedings, but are not entitled to put forth evidence.82

**8.5. Highlights of ISDS cases under international investment agreements**83

These are set out below.

**Claimants:**

- 45% of the claims were made by medium-sized enterprises and multinational enterprises (MNEs);
- 22% of the claims were made by small and medium-sized enterprises (SMEs), including individuals and very small corporations often family owned; and
- 33% of the claims provide little or no public information on the type of claimant.

**Case subjects:**

- 90% of ISDS cases concern administrative measures; and
- more than 70% of all new claims concern investments in services sectors, including the supply of electricity and gas, telecommunications, construction, tourism, banking, real estate services, retail trade, media and advertising.

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82. Only other members can make written submissions under article 10 of the DSU.

The popularity of ISDS up to the end of 2013:
- 568 ISDS claims were brought during this period;
- 274 cases were concluded;
- 299 cases were initiated by claimants from the European Union, representing 53% of all known disputes; and
- countries most often challenged included both developing and developed countries, i.e. Argentina (53 cases), Venezuela (36), Czech Republic (27), Egypt (23), Canada (22), Ecuador (22), Mexico (21), Poland (16), the United States (15) and India (14).

Commencement of proceedings:
- in 50% of the cases initiated against Member States of the European Union, the ISDS tribunal dismissed all of the claims; and
- in 19% of the cases, the ISDS tribunal declined jurisdiction.

Success rate of ISDS cases:
- 43% of the cases were decided in favour of the state;
- 31% of the cases were decided in favour of the investor; and
- 26% of the cases were settled.

Average costs for a claimant are around USD 8 million, of which:
- 82% is incurred for legal counsel and experts;
- 16% represents fees of arbitrators; and
- 2% is incurred for administrative costs of proceedings.

9. Conclusions

The proposals of the European Union regarding investment protection and ISDS represent a substantial advance in the balancing of the interests of the states hosting investments and investors themselves. As ISDS is sometimes criticized for giving too much to MNEs, the European Union has tried to strengthen the position of host states by granting them greater control over the proceedings related to the TTIP and ensuring numerous carve-outs and exceptions with reference to a state’s right to regulate certain sectors. This is of particular interest in retaining interpretative rights with reference to TTIP in the hands of the European Union and the United States, even in respect of an arbitral tribunal. A further significant change is the attempt to make all of the proceedings completely transparent.

It appears to be clear that, if the TTIP takes the form described in section 4., the position of investors will be constrained. This can be seen not only in ISDS proceedings but also, primarily, in the investment protection provisions as proposed.

The substantial novelties of ISDS under the TTIP as proposed are an appellate mechanism and a permanent court. With regard to the appellate mechanism, the question may be raised as to whether creating this mechanism constrains some of the advantages of arbitration. In this respect, the proposal goes even further than the CETA draft since a bilateral appellate mechanism will be introduced directly. An even more interesting proposal is the institutionalization of an arbitral tribunal in the form of a permanent court. On the one hand, this may give rise to technical and organizational challenges, but, on the other, it could ensure that disputes would be decided by competent, independent and impartial arbitrators and in accordance with known and predictable legal principles.
Annex: WTO Dispute Resolution Process

A Flow Chart of the Panel Process

Consultations
(Members may request panel if no solution found within 60 days or request good offices, conciliation or mediation by Director-General)

DSB establishes panel
(no later than at 2nd DSB meeting)

Terms of reference
(standard terms unless special terms agreed within 20 days)
Composition
(to be agreed within 20 days or decided by Director-General)

Panel examination
(in general not to exceed 6 months, 3 months in cases of urgency)
Meetings
with parties
Meeting
with 3rd parties

Panel submits report to parties for comments
(first descriptive part of report, subsequently complete interim report)
Interim Review meeting - if requested

Panel circulates report to DSB

DSB adopts panel report
(within 60 days unless appealed)

Appellate Review
(not to exceed 90 days)

DSB adopts Appellate Report
(within 30 days)

DSB monitors implementation of adopted panel/Appellate Body recommendations
(to be implemented within defined "reasonable period of time")

Parties negotiate compensation pending full implementation

DSB authorizes "retaliation" pending full implementation
(60 days after expiry of "reasonable period of time")