Pace Law Review

Volume 34
Issue 3 *Summer 2014*

Article 3

July 2014

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Recommended Citation
Limor Riza, *Taxpayers' Lack of Standing in International Tax Dispute Resolutions: An Analysis Based on the Hybrid Norms of International Taxation*, 34 Pace L. Rev. 1064 (2014)
DOI: https://doi.org/10.58948/2331-3528.1867
Available at: https://digitalcommons.pace.edu/plr/vol34/iss3/3

Taxpayers' Lack of Standing in International Tax Dispute Resolutions: An Analysis Based on the Hybrid Norms of International Taxation

Limor Riza[*]

Preface

Assume a hypothetical but very plausible scenario in which you had invested substantial fortune and efforts in a cross-border transaction. You entered this transaction after a thorough field study and you even consulted some tax experts in order to estimate your potential tax burden. The tax advisors succeeded in calming you down by drawing your attention to the fact that the transaction will be carried out in a state that has signed a bilateral tax treaty with your resident state. That means that you will avoid the problem of double taxation. Willingly you carried out the transaction and the outcome is quite successful and even exceeded your expectations. You are aware that you have to share your success with the tax authorities and pay income tax. Though, suddenly you realize that since your transaction is quite complicated and unusual both states claim full share and you face double taxation. You know that there is a procedure stipulated in the treaty enabling the states to resolve problems of double taxation. Now, it is your money at stake, but the two contracting states exclude you from their negotiation. To put it gently, you are not satisfied with this conduct; you believe it is unfair since it is your money and you should have standing in the procedure. I am awfully sorry to inform you but I believe you should not. ***If you are interested to know why I believe that you and other taxpayers should not have a standing in conflict resolutions arising due to double tax treaties you are welcome to read this paper.***

This paper examines whether a taxpayer should have "standing"[1] in

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1. "Standing" is a term usually applicable to federal courts, but I analogize it here with the right to be heard in international dispute resolutions. *See* BLACK'S LAW DICTIONARY 1536 (9th ed. 2009).

international dispute resolutions. To answer this question the primary task is to identify the nature of international taxation. In other words, this paper discusses how to classify the field of international taxation. Is it part of public international law, private international law (*i.e.*, conflict of laws), national (domestic) law, or is it a hybrid field that requires specific attention? Making this distinction is vital for resolving disputes when a taxpayer is taxed twice for cross-border transactions in cases where the double tax convention is unclear and both contracting states claim full or partial tax on accrued income.[2]

In 1924, the Permanent Court of International Justice defined dispute as "disagreement on a point of law or fact, a conflict of legal views or of interests between two persons."[3] In the case brought before the Court in 1924, it determined that the dispute started between an individual and a state, but then the individual's government "took up the case. The dispute then entered upon a new phase; it entered the domain of international law, and became a dispute between two States."[4] If we analogize that case to a tax case derived by a cross-border transaction, there is no doubt that we have a dispute — a dispute on tax liability. But there are still two lingering doubts. First, is it an *international* dispute? And second, who are the parties to it? If one examines the current mechanisms available in the OECD Model Tax Convention for resolving double taxation disputes, one realizes that the taxpayer's standing is somewhat ambiguous. In order to clarify this ambiguity we need to address the question of categorizing the conflict as a national or international one.

The question at stake is whether a taxpayer should be a party to the dispute resolution process. In this paper, the cases cited are limited to where double tax treaties apply. I reserve the cases where they are inapplicable to further discussion.

Part I highlights the tax complexity arising from cross-border transactions. Since the article focuses on OECD Model dispute resolution mechanisms, Part II briefly introduces the model's history and

2. It seems that tax conflicts are inevitable and can be avoided only by super-national authority as argued in MARIO ZÜGER, ARBITRATION UNDER TAX TREATIES: IMPROVING LEGAL PROTECTION IN INTERNATIONAL TAX LAW 3 (2001).

3. Mavrommatis Palestine Concessions (Greece v. U.K.), 1924 P.C.I.J. (ser. B) No. 3, at 11 (Aug. 30) [hereinafter Mavrommatis Palestine Concessions]. This verdict represents the orthodox approach of diplomatic protection. *See* Zachary Douglas, *The Hybrid Foundations of Investment Treaty Arbitration*, 74 BRIT. Y.B. INT'L L. 151, 165 (2004).

4. Mavrommatis Palestine Concessions, at 11.

its official aims. Part III discusses the available dispute resolution mechanism in the OECD Model — the Mutual Agreement Process (MAP) and Arbitration. Part IV reviews the hybrid elements of international taxation. This paper suggests that international taxation has both national and international characteristics. This hybrid nature is the basis of the discussion in Part V: after identifying the parties to the international tax dispute, this paper suggests two solutions to the research question — the apparent and normative solutions. In the former, a taxpayer should have standing in the international dispute, though recall that this solution is not based on normative grounds. The normative rationale introduces the equity principle whereby taxpayers should have no official role in resolving the dispute. Finally, this paper offers a brief recommendation in Part VI.

I. The Complexity Arising from Cross-Border Transactions

It is commonly accepted that there is an ongoing globalization process whereby goods, capital, services, people and ideas move from one state to another. One example is international transactions where a foreign corporation engages in economic activities with another corporation in a different jurisdiction. Another very common example is multinational enterprises that conduct business worldwide. Modern laws endeavor to resolve disputes arising from these kinds of contemporary cross-border transactions.

One aspect of law relevant to cross-border transactions is tax law or more precisely international tax law (though some conflicts may occur between one state's bank secrecy law and another's tax laws).[5] In the above example of a corporation doing business in a different jurisdiction, it may be liable to double taxation. Many countries have signed bilateral double tax conventions to mitigate this problem.[6] Those conventions regulate how to divide the tax liability between the contracting states. For instance, the United States has signed double tax treaties with more than sixty countries,[7] and the United Kingdom with more than 100.[8] Today,

5. An example is the UBS saga where American tax authorities demanded disclosure of American citizens' bank accounts kept in Swiss banks (UBS). *See* Charles H. Gustafson, *The Role of International Law and Practice in Addressing International Tax Issues in the Global Era*, 56 VILL. L. REV. 475, 475-78 (2011).

6. This article focuses only on the aim of reducing double taxation and not on the other official or unofficial goals of double tax treaties.

7. *See United States Income Tax Treaties – A to Z, available at* http://www.irs.gov/Businesses/International-Businesses/United-States-Income-Tax-

the global network of bilateral double tax treaties exceeds 2,000.[9]

II. Introduction to Double Taxation and the OECD Model Tax Convention

In order to answer the first question I need to address the classification of the field of international taxation. This classification has little relevance to straightforward cases that raise no particular dilemmas for tax division between contracting states. It is significant, however, in tax disputes between a taxpayer and the two contracting states. Today, double tax conventions based on either the OECD or the UN model include a specific article (Article 25) that establishes a mutually agreed procedure for eliminating double taxation and resolving conflicts of interpretation. This procedure invites competent authorities to mutually agree to resolve disputes where a taxpayer is subject to taxation that is not in accordance with the convention.

Since state tax laws may conflict in the international arena, a taxpayer may be subject to double taxation. Double taxation could arise in various scenarios where a state taxes its residents on extraterritorial income. In the classical example, double taxation occurs when a resident of state X generates income in state Y. State X can tax its resident by virtue of its residence-based regime and state Y by virtue of its territory-based regime. Moreover, double taxation can arise due to double "residence" or "territory". Sometimes countries unilaterally solve the problem of double taxation by recognizing a tax relief in national law in the form of foreign tax exemption, credit[10] or deduction. But in order to eliminate or at least mitigate the double tax problem many countries have signed bilateral double tax conventions usually based on either the OECD or the UN model. Those models serve as a noncompulsory format and negotiation platform between states.[11] Although the number of such treaties is growing,[12] there is no multinational double tax convention as yet. It seems that because of distinct domestic tax regimes

Treaties---A-to-Z.

8. *See Double Tax Treaties*, *available at* http://www.icaew.com/en/library/subject-gateways/tax/double-tax-treaties.

9. *See* REUVEN S. AVI-YONAH, INTERNATIONAL TAX AS INTERNATIONAL LAW: AN ANALYSIS OF THE INTERNATIONAL TAX REGIME 3 (2007); *see also* Victor Uckmar, *Double Taxation Conventions*, *in* INTERNATIONAL TAX LAW 149 (Andrea Amatucci ed., 2006).

10. *See, e.g.*, 26 U.S.C. § 901 (2012) (the foreign tax credit applied).

11. *See, e.g.*, Uckmar, *supra* note 9, at 151.

12. *See, e.g.*, *id.* at 149.

and interests it would be difficult to formulate such a convention.[13]

As aforesaid, the OECD model is a popular model that serves as the basis for many bilateral conventions. Thus, it has attracted widespread scholarly attention. Therefore, I will use it as my main point of reference.

III. Dispute Resolution Mechanisms in the OECD Model

A. *The Default Dispute Resolution Mechanism: Mutual Agreement Process*

Article 25 of the OECD Model stipulates some dispute resolution guidelines. First, Articles 25(1) and 25(2) regulate the procedure where taxpayers are taxed not in accordance with the treaty. Second, Article 25(3) is designed to resolve difficulties related to the treaty's interpretation and application and solve the problem of lacunas.

In case Article 25(1) applies, the taxpayer may present his matter to "the competent authority of the contracting state of which he is a resident".[14] The taxpayer may do so even if he has not exhausted all remedies under domestic law.[15] If the case is justified, the competent authority has to endeavor to settle the controversy.[16] Thus, a prerequisite to entering a mutual agreement is that "the objection appears to [the competent authority] to be justified . . . ."[17] This condition grants the competent authority with discretion whether to accept or reject the case.[18]

13. On the difficulties of formulating a multination convention, see paragraph 37 of Introduction to the OECD Model Tax Convention. Organisation for Economic Co-operation and Development [OECD], *Model Tax Convention on Income and on Capital*, I-11, ¶ 37 (July 22, 2010), *available at* http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/model-tax-convention-on-income-and-on-capital-2010_9789264175181-en [hereinafter OECD, *Model Tax Convention*].

14. *Id.* at M-59.

15. *See id.* at C(25)-12, ¶ 31.

16. *See id.* at C(25)-12, ¶ 2.

17. Article 25(2) of the OECD, *Model Tax Convention*, *supra* note 13, at M-59. *But* see Ehab Farah, *Mandatory Arbitration of International Tax Disputes: A Solution in Search of a Problem*, 9 FLA. TAX REV. 703, 717, 734-36 (2009) (Farah criticizes this precondition. Moreover, Farah finds fault with the OECD arbitration article since it fails to achieve the two main goals of double tax treaties: preventing double taxation and preventing tax avoidance. Farah suggests a twofold evaluation test: first, a mandatory and binding arbitration provision should achieve both goals and second, the provision should operate so as to resolve tax disputes).

18. *See, e.g.*, Hugh Ault, *Improving the Resolution of International Tax Disputes*, 7 FLA. TAX REV. 137, 140 (2005).

If the competent authority cannot overcome the obstacle by itself, it should implement the second stage of dispute resolution and resolve the case "by mutual agreement with the competent authority of the other contracting state . . . ."[19] It should be noted that if Article 25 is not adopted in a double tax treaty, the taxpayer will be required to bring his matter before the judiciaries in both contracting states.[20] There is a parallel authority to deal with the matter: the taxpayer can bring the case before a local judiciary and simultaneously present it to his competent authority.[21] If so, the case may reach both a domestic and an international resolution. Problems may arise naturally if the two resolutions conflict. Another possible conflict between domestic and international law may easily arise in the application of the mutual agreement process.[22] To avoid conflicts the taxpayer is usually required to accept the mutual agreement and to withdraw his relevant domestic lawsuit(s).[23] Another quandary is whether the competent authority is bound by its domestic law or free to deviate from it.[24] Despite its importance, however, this issue is beyond the scope of this article.

The mutual agreement process is the most commonly used mechanism.[25] Nevertheless, it has at least one serious drawback: mutual agreement processes can take a long time to complete, and during this time new complications may arise.[26] Moreover, the procedure is costly to both the contracting states and the taxpayer.[27]

Another shortcoming of MAP is where competent authorities follow the mutual agreement procedure, but do not have to reach an agreement. They are obliged to make their best effort to mutually agree on the case but are under no obligation to reach a conclusion: their only duty is to negotiate.[28] This is perhaps the main drawback of the procedure, a drawback Article 25(5) has been designed to remedy. Despite its

19. Article 25(2) of the OECD, *Model Tax Convention*, *supra* note 13, at M-59.

20. *See id.* at C(25)-2, ¶ 7.

21. *See id.* at C(25)-1, ¶ 2.

22. *See id.* at C(25)-10 to -11, 13, 16-17, ¶¶. 27, 35, 42-43 (discussing some other examples of conflict between the mutual agreement process and domestic law).

23. *See id.* at C(25)-17, ¶ 45.

24. *See* Ault, *supra* note 18, at 140-41.

25. *See* Maya Ganguly, *Tribunals and Taxation: An Investigation of Arbitration in Recent US Tax Conventions*, 29 WIS. INT'L L.J. 735, 750 (2012) (Ganguly examines the pros and cons of the arbitration mechanism and concludes that, despite its merits, the current formulation of arbitration in double tax treaties suffers from many weaknesses).

26. *Id.*; *see also* Ault, *supra* note 18, at 139.

27. *See id.* at 139 (discussing other potential costs).

28. *See* OECD, *Model Tax Convention*, *supra* note 13, at C(25)-14, ¶ 37.

shortcoming the MAP is as aforesaid the default dispute resolution mechanism in the OECD Model.

B. *The Second Dispute Resolution Mechanism: Arbitration*

Article 25(5) provides for arbitration in disputes originated by Articles 25(1)-(2).[29] It was added to the OECD Model in 2008 after lengthy discussions[30] and it is a quite common dispute resolution mechanism in bilateral economic agreements.[31]

Arbitration is a dispute resolution process settled outside the court.[32] The dispute is settled by a neutral third party — the arbitrator — who adjudicates the disputed issue and his decision is both binding and final.[33]

Article 25(5) added the practice of mandatory arbitration with the reservation that "[i]n some states, national law, policy or administrative considerations may not allow or justify the type of dispute resolution envisaged under this paragraph . . . ."[34] The taxpayer may initiate an arbitration process if the mutual agreement process fails to end after two years.[35] The arbitration process is available to the taxpayer only when

29. *Id.* at C(25)-27, ¶ 73.

30. Before this amendment some OECD proposals were made. *See* OECD, *Improving the Process for Resolving International Tax Disputes* (July 27, 2004), *available at* http://www.oecd.org/ctp/taxtreaties/33629447.pdf [hereinafter OECD, *Improving the Process]*; OECD, *Proposals for Improving Mechanisms for the Resolution of Tax Treaty Disputes* (Feb. 2006), *available at* http://www.oecd.org/tax/disputeresolution/36054823.pdf [hereinafter OECD, *Tax Treaty Disputes*].

31. Seventy-five percent of international economic agreements provide for an arbitration mechanism. This percentage is quite high relative to other international agreements such as environmental, human rights, and security agreements. *See* Barbara Koremenos, *If Only Half of International Agreements Have Dispute Resolution Provisions, Which Half Needs Explaining?*, 36 J. LEGAL STUD. 189, 201 (2007).

32. BLACK'S LAW DICTIONARY 119 (9th ed. 2009).

33. *Id.*

34. *See* OECD, *Model Tax Convention*, *supra* note 13, at M-60 n.1, C(25)-24, ¶¶ 65-67*; see also* William W. Park, *Control Mechanisms in International Tax Arbitration*, *in* RESOLUTION OF TAX TREATY CONFLICTS BY ARBITRATION 35, 38-39 (1994) (discussing the problem of enforcing the arbitral decision). On the other hand, Park also questions the ability to challenge the arbitral decision on grounds of bias, excess of authority or refusal to let one party present its case. *Id.*

35. McIntyre challenges this provision by believing that the taxpayer is not party to the conflict and thus should not have the right to initiate the arbitration process. If awarded this right, then reciprocity requires, at the very least, that competent authorities have this right too. Michael J. McIntyre, *Comments on the OECD Proposal for Secret*

the competent authority has initiated a mutual agreement process and the tax problem has not been mutually resolved.[36] That means that if competent authorities have reached an agreement that is not to the taxpayer's satisfaction, he cannot bring his case to arbitration. This also means that the arbitration process is only applicable for deadlocks and naturally for cases which have been initially found justified by the competent authority. Thus, arbitration is inapplicable if the competent authority has refused to initiate a mutual agreement process in the first place.[37] Mandatory arbitration has mainly two advantages. First, it forces a solution (since mutual agreement can end in a stalemate); and second, it expedites the procedure.[38]

The arbitration settlement's validity is somewhat limited. First, it is only binding with regard to the particular matters submitted to arbitration.[39] Second, to avoid conflicting decisions, Article 25(5) states that arbitration is not available if a domestic court has already resolved the case.[40]

Although Article 25(5) embraces mandatory arbitration, the precise arbitration procedure is not stipulated in the OECD Model, which leaves it to mutual decision by the contracting states. Some believe that it is inefficient for arbitrators to set up ad-hoc rules and that more detailed guidelines should be provided,[41] which are absent in the OECD model. Indeed, some global organizations and NGOs have been supporting the implementation of arbitration in cross-border transactions; these include the London Court of International Arbitration ("LCIA"),[42] and International Chamber of Commerce ("ICC").[43] In 2000, the ICC's

and Mandatory Arbitration of International Tax Disputes, 7 FLA. TAX REV. 622, 640 (2006). *See also infra* Part V.C.

36. *See* Article 25(5) of the OECD, *Model Tax Convention*, *supra* note 13, at M-59 to 60.

37. *See* Farah, *supra* note 17, at 716, 734-36.

38. *See* Gustaf Lindencrona, *Recent Development of Tax Treaty Arbitration*, *in* RESOLUTION OF TAX TREATY CONFLICTS BY ARBITRATION 3, 8 (1994); *see also* Züger, *supra* note 2, at 65-108 (on mandatory arbitration).

39. *See* OECD, *Model Tax Convention*, *supra* note 13, at C(25)-30, ¶ 83.

40. *See id.* at C(25)-28, ¶ 76. In other cases, where the taxpayer is able to take his case to domestic court after an arbitral decision, McIntyre believes the taxpayer should bear the costs of arbitration and reimburse the competent authorities for wasted resources. McIntyre, *supra* note 35, at 642-43.

41. *See, e.g.*, McIntyre, *supra* note 35, at 641-42.

42. *See* THE LONDON COURT OF INTERNATIONAL ARBITRATION, http://www.lcia.org/Default.aspx.

43. *See* INTERNATIONAL CHAMBER OF COMMERCE, http://www.iccwbo.org (The ICC is an NGO established in 1919 to represent worldwide businesses and serve as the world

Commission on Taxation published a policy statement on Arbitration in Tax Matters,[44] which can be easily adopted in bilateral tax treaties.

Within the mutual agreement process, other dispute resolutions can be implemented on ad-hoc basis in lieu of the arbitration process.[45] One popular alternative is mediation. Since the OECD Model provides for arbitration, however, we shall focus on this dispute resolution mechanism in what follows.

C. *The Merits Pros and Cons of Arbitration*

For several decades now, scholars and practitioners have been interested on how to resolve international tax disputes. Already in the 1951 Fifth Congress of the International Fiscal Association two main mechanisms were suggested: an international judicial tax tribunal and arbitration.[46] This issue was not resolved in this congress and was raised again in further discussions.[47]

This paper is not aimed at weighing the pros and cons of arbitration. The aim of this brief, by no means exhaustive discussion is merely to illuminate the advantages and disadvantages of arbitration. For the sake of clarity, though, I will briefly elaborate on the matter.

The merits of arbitration can be compared to the main available dispute resolution mechanisms in the international arena – mutual agreement and judiciary procedures. Although arbitration is supplementary and substitutive of mutual agreement processes a brief comparison of the two can highlight its merits.

Process finalization argument: Arbitration is similar to a judicial decision and differs from mutual agreement in that that the conflict

business organization).

44. Int'l Chamber of Commerce [ICC], *Policy Statement for Arbitration in International Tax Matters* (May 3, 2000), http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2002/Arbitration-in-International-Tax-Matters--Bilateral-Convention-Article/. *Contra* OECD, *Model Tax Convention*, *supra* note 13, at C(25)-36 to -43 (the Annex to Article 25 Commentary titled *Sample Mutual Agreement on Arbitration* provides a sample form of agreement that competent authorities may use as a basis for a mutual agreement to implement the arbitration process); *but see* Park, *supra* note 34, at 48-49 (providing that an international tax arbitration clause should include five elements: (1) applicable procedural rules; (2) the mechanism for determining the arbitrator fees; (3-4) the place and language of arbitration, and (5) the number of arbitrators).

45. *See* OECD, *Model Tax Convention*, *supra* note 13, at C(25)-31, ¶86.

46. Lindencrona, *supra* note 38, at 3.

47. *Id.*

reaches an award. In this sense, both arbitration and judiciary processes are preferable to mutual agreement process.[48]

Neutrality argument: In addition, international arbitration is preferable to mutual agreement since the outcome is based on an independent forum rather than on interested and biased authorities, which prioritize the interests of their state.[49] Independent arbitrators can overcome the biased advantage given to the host state, which serves at the same time as a "party, regulator, legislator and adjudicator."[50] Where large-scale trading and financial activities conducted by multinational enterprises are involved, each state has an interest not to lose its economic share.[51]

Although the amendment of the OECD Model's Article 25 includes arbitration as a cumulative dispute resolution mechanism, the more material comparison is between arbitration and judiciary procedures as discussed below.

Efficiency argument: One apparent advantage of arbitration is cost and time saving[52] relative to the regular judicial process.[53] Arbitration is free of procedural and evidentiary rules and thus considered an efficient dispute resolution mechanism.[54] Moreover, the arbitral decision is final and the parties cannot appeal it, which means it is significantly more cost-effective[55] (albeit at the expense of fairness, as discussed below).[56] This apparent advantage is not absolute, however. Recently, significant progress has been achieved in allowing some arbitration decisions to be

48. *See also id*. at 8.

49. *See, e.g.*, Barry Bracewell-Milnes, *Summary of Proceedings of the Seminar "Resolution of Tax Treaty Conflicts by Arbitration*", in RESOLUTION OF TAX TREATY CONFLICTS BY ARBITRATION 61, 62 (1994).

50. This quotation was mentioned with regard to investment treaty arbitration. *See* Susan D. Franck, *The Nature and Enforcement of Investor Rights Under Investment Treaties: Do Investment Treaties Have a Bright Future*, 12 U.C. DAVIS J. INT'L L. & POL'Y 47, 71-72 (2005) [hereinafter Franck, *The Nature and Enforcement*].

51. *See* Allison Christians, *How Nations Share*, 87 IND. L.J. 1407, 1408 n.4 (2012) (It is estimated that sixty percent of global trade is carried out by multinational enterprises).

52. *See* Park, *supra* note 34, at 36; Ganguly, *supra* note 25, at 751-52 (Ganguly weighs the pros and cons of arbitration to resolve the double taxation problem and believes that, despite the merits of arbitration, its current formulation in double tax treaties suffers from many disadvantages).

53. *See supra* note 38.

54. Ganguly, *supra* note 25, at 746-47.

55. *Id.* at 746.

56. *Id.*

appealed.[57] This is not the normal procedure, but given its availability it would be overly simplified to state that arbitration awards are completely final.

Neutrality argument: Another advantage in the international arena is the neutral nature of arbitration. It seems that when a conflict arises between taxpayer X, resident of state X, and Y, resident of state Y and taxpayer X will often be reluctant to litigate in state Y and vice versa. Thus, arbitration is more politically and procedurally neutral.[58]

Fairness and confidentiality argument: It seems that the Achilles heel of the OECD arbitration mechanism is its secrecy. In other words, the main drawback of arbitration and mutual agreement procedures[59] compared to judicial procedures is lack of transparency. The public has access to court verdicts and can scrutinize the outcome of the process.[60] This not only gives the public a better understanding of the law and its implementation, but also provides legal precedents for later disputes.[61] Conversely, international tax arbitration is totally obscure from the public.[62] The arbitration process, including its final decision, is not open

57. *See*, *e.g.*, AMERICAN ARBITRATION ASSOCIATION, OPTIONAL APPELLATE ARBITRATION RULES (November 1, 2013), available at https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTAGE2016218.

58. *See* Park, *supra* note 34, at 36.

59. Most mutual agreement procedure documents in the United States are not open to the public (for a more detailed classification of competent authority resolutions, see Christians, *supra* note 51, at 1433-34; McIntyre, *supra* note 35, at 631 ("The single most objectionable feature of the OECD Proposal is its provision for total secrecy.")). McIntyre criticizes the OECD Proposal for Improving Mechanisms for the Resolution of Tax Treaty Disputes (2006) mainly for the arbitration process' confidentiality and the unnecessarily costly process in cases of double non-taxation, most of which are transfer pricing cases which can be dealt within the improved OECD transfer pricing rules. McIntyre, *supra* note 35, at 627-29. Since arbitration is costly, McIntyre suggests limiting the mandatory arbitration mechanism to double taxation cases only and to the exclusion of double non-taxation. *Id.* at 646. He finds no rationale in mandatory arbitration in cases that result in increasing international tax avoidance. McIntyre notes other flaws in the proposal that can, however, be easily remedied. *Id.* at 638-46.

60. *See* Ganguly, *supra* note 25, at 751.

61. This argument is applied to domestic judicial courts, despite being applicable, *mutatis mutandis*, to international judicial courts as well. *See* Christians, *supra* note 51, at 1430-31.

62. Christians claims that "the international tax arbitration process is designed to be completely inaccessible to the public. In other words, international tax arbitration is intentionally designed not to produce international tax law." *See* Christians, *supra* note 51, at 1437 (Christians demonstrates how "soft law" in international tax disputes involves high social costs. Soft institutional mechanisms in the international tax regime disguise relevant information from the public. Citizens of each nation thus lack information about the allocation of global revenues. They cannot be aware if their government claims less

for disclosure. When decisions are confidential they cannot guide others in future disputes, thus impairing the development of customary law.[63] The main counter-argument to this is the efficiency argument discussed above.[64]

Confidentiality has another aspect, though. A confidential adjudicative process is a fertile ground for corruption. When parties cannot review the process it is easier to act dishonestly.[65] This problem can be minimized if the parties to the secret process are private self-interested parties that have an incentive to expose dishonesty when their money is at stake. On the other hand, when the parties are states and the money at stake is public funds, this incentive is fairly insignificant.[66]

Sovereignty argument: Arbitration impairs state sovereignty since internal tax revenue decisions are being resolved by third parties — the arbitrators.[67] Since resolving some international tax conflicts requires domestic law interpretation, some scholars argue that interpretation should be left to domestic courts and not to any international third party.[68] This claim has some truth to it, although it is valid also to MAPs and judiciary procedures (even domestic courts) since globalization interferes with sovereignty. On the other hand, since the dispute concerns only one taxpayer and only his tax liability and not the truly national matters, this interference is somewhat negligible.[69]

Harmonization v. Inconsistency argument: If one focuses on the specific dispute, we have seen that arbitration carries many advantages in terms of quick and efficient resolution. However, if one considers the general system beyond the specific individual, an international court may be preferable. Not only can such a court develop legal tax rules as discussed under the fairness and confidentiality argument, but its byproduct can be tax harmonization.[70] Though, even for an individual,

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of the global income and thus levies them more heavily. Without this relevant information, it is impractical to assess tax policy on either efficiency or fairness principles. Therefore, the author aims at examining the social cost of obscurity in international tax regime).

63. *See* Ganguly, *supra* note 25, at 771; *see also* McIntyre, *supra* note 35, at 632.

64. *See supra* notes 52-57 and accompanying text.

65. McIntyre, *supra* note 35, at 626, 632.

66. *Id.* at 626, 636.

67. *See, e.g.*, Ganguly, *supra* note 25, at 752; Farah, *supra* note 17, at 709.

68. *See, e.g.*, McIntyre, *supra* note 35, at 626 (adding that "The OECD seems to recognize that an international tribunal should not act as a court of review for the decisions of domestic courts.").

69. Ganguly, *supra* note 25, at 753.

70. In Adam H. Rosenzweig, *Thinking Outside the (Tax) Treaty*, 2012 WIS. L. REV.

arbitration may be troublesome since there are various arbitral tribunals that can reach inconsistent outcomes. This inconsistency not only interferes with harmonization but also with certainty – a vital feature in economic activities.[71]

Some scholars conclude that despite the drawbacks of arbitration,[72] it can serve as the appropriate dispute resolution mechanism with some modifications.[73] This article's basic approach is that no dispute resolution mechanism is perfect, and it does not attempt to settle the question which mechanism is better on either efficiency or neutrality grounds. Instead, this article examines whether the dispute resolution mechanisms proposed by the OECD Model should treat the taxpayer as a party to the dispute. After this discussion this paper may be less undecided as to which mechanism is preferable, but in order to answer this question, some light needs to be shed on the nature of international

717, 724 (2012), Rosenzweig treats international taxation as a public good and claims it is misleading to support greater cooperation between countries in the international tax arena. Bilateral treaties, which mainly exclude small states (often offshore tax havens), do not enhance international cooperation. *Id.* at 721-24. On the contrary, in excluding these tax havens they actually compromise cooperation. *Id.* at 725. Therefore, Rosenzweig suggests new mechanisms, such as a "lottery" mechanism, to induce those small countries to cooperate. *Id.* at 726, 755-57. Conversely, in Yariv Brauner, *Integration in an Integrating World*, 2 N.Y.U. J.L. & BUS. 51 (2005), Brauner supports international coordination. According to Brauner, the underlying reason for favoring this coordination is the imputation system. *Id.* This system is preferable to two-tier taxation. Brauner claims that, although many countries have abandoned the imputation system due to globalization, the integration system can be reintroduced through international coordination of tax policies. *Id.* at 85-90. Likewise, in Anthea Roberts, *Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System*, 107 AM. J. INT'L L. 45, 62 (2013), Roberts believes that international courts generally have the power to create substantive law.

71. *See* Franck, *The Nature and Enforcement*, *supra* note 50, at 56-58 (This flaw was mentioned with regard to bilateral investment treaties); *see also* Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521, 1525, 1558 (2005) [hereinafter Franck, *Legitimacy Crisis*]. However, Franck notes that inconsistency has some advantages, such as highlighting the legal "flaws within the system." Franck, *The Nature and Enforcement*, *supra* note 50, at 68; *see* Franck, *Legitimacy Crisis*, at 1612-13.

72. *See* Farah, *supra* note 17, at 749 ("Scholars have raised additional concerns regarding issues such as the selection of the arbitration panel, implementation of the arbitration decision and conflicts with domestic laws, time limitations, precedential value of the decisions, taxpayer participation in the proceedings, the binding aspect of the decision to the States and to the taxpayer, appointing the arbitrators, review of the arbitration decision, the costs and expenses of the proceeding, legal status of the treaty and commentary and, the language of the arbitration.").

73. *See* Ganguly, *supra* note 25, at 772; *see also* McIntyre, *supra* note 35, at 636-37 (suggesting seven factors to consider in order to determine whether arbitration is suitable as a dispute resolution mechanism).

tax law.

IV. The Hybrid Elements of International Taxation and Its Applications

The issue of the appropriate dispute resolution mechanisms in international taxation has received wide resonance.[74] Nevertheless, if we wish to design the optimal dispute resolution instrument we have to fully understand what international taxation is. Although the vast literature on international taxation is somewhat lacking, recently this topic has received attention with regards to investment treaties, discussed below.[75] Though, this tax literature attempting to resolve double tax conflicts lacks a detailed analysis of classification of international taxation.

If an international tax regime does exist, is it part of international law?[76] Avi-Yonah believes not only that there is such a regime (partly given the numerous and similar bilateral tax treaties), but also that it is part of international law. Avi-Yonah argues that it relies on two principles: the *single tax principle* (meaning that a given income is taxed once; no double taxation but also no double non-taxation) and the *benefits principle* (meaning that active income should be taxed at source and passive income at residence).[77] This approach is controversial, however, with some scholars believing that there is no international tax regime and thus countries are sovereign to adopt any international tax rule they prefer.[78] For the purposes of this article, it will not be necessary to determine whether international tax law exists or not, though the hybrid form is emphasized.

Although the categorization of law is somewhat archaic, we still tend to classify fields of law to enhance our analysis. Two common pairs of distinctions are between international and national law, and private and public international law. International taxation, or more specifically international double tax conventions, carries elements of both international and national law, and public and private international law.

First, in the international arena, tax treaties are tangential to public international law, which covers agreements and conventions between

74. *See generally* Farah, *supra* note 17; Ganguly, *supra* note 25; Lindencrona, *supra* note 38; Park, *supra* note 34.

75. For the development of investment treaties, see Franck, *Legitimacy Crisis*, *supra* note 71, at 1525.

76. *See generally* AVI-YONAH, *supra* note 9.

77. *See id.* at 9-13, 182.

78. *See* references in *id.* at 1.

states (*jus inter gentes*). More precisely, international tax treaties are conventional international agreements and are thus one of the main sources of public international law. Those treaties are mainly based on OECD or UN models and thus share similarities (even in the order of the articles).[79] Moreover, countries have to amend domestic laws in order to apply general rules set by the OECD (such as transfer pricing guidelines).[80] Interestingly, although this is beyond the scope of this article, some claim that *customary* international tax law exists.[81] The main justification for a customary international tax regime is that some tax rules are ubiquitous. For example, the nondiscrimination rule (Article 24 of the OECD Model)[82] and the arm's-length principles (adopted in Article 9)[83] are applicable in international transactions even when a double tax treaty is not.[84]

Second, international tax law also has similarities to private international taxation[85] since it involves, among other factors, a "foreign" element, although it is naturally not identical to private international law. From the taxpayer perspective it is indeed a private matter that in the case of double taxation involves two conflicting tax jurisdictions that can govern the dispute.[86]

Third, international tax law naturally involves domestic law since double tax treaties adopt many mechanisms from internal law. For example, taxpayer's residency is always determined by domestic law[87] (unless there is double residence).[88] In addition, the treaty becomes part of domestic law either automatically (the monism approach) or after a process of declaration or ratification (the dualism approach). According to the latter, each country applies different rules on how to adopt a treaty into the domestic law. Nevertheless, eventually the treaty is adopted by

79. *See id.* at 3.

80. *See, e.g.*, *id.* at 4.

81. *See, e.g.*, *id.*

82. *See, e.g.*, *id.* at 6.

83. *See, e.g.*, *id.* at 6-7, 102-23.

84. Avi-Yonah gives many other examples of tax rules that can be viewed as part of customary international law, such as the residence rule and CFC rules. *Id.* at 23, 25.

85. On the interesting historical private-public international law dichotomy in legal positivism, see M. W. Janis, *Individuals as Subjects of International Law*, 17 CORNELL INT'L L.J. 61, 61-64 (1984).

86. For an example regarding private international law, see JAMES FAWCETT & JANEEN M. CARRUTHERS, PRIVATE INTERNATIONAL LAW (Sir Peter North ed., 14th ed. 2008).

87. *See* OECD, *Model Tax Convention*, *supra* note 13, at R(19)-31, ¶104.

88. *See id.*

domestic law and is legally binding.

As stated above, the tax literature on double taxation lacks a thorough analysis of international tax nature. However, such a discussion has been conducted recently alongside the growth[89] of investment treaties (with regard to investment treaties). Investment treaties are officially aimed at encouraging and promoting mutual foreign investments between the contracting states.[90] They encourage the transfer of capital between the signatory's states and contribute mainly to host states and private investors.[91] Investment treaties serve as an economic charter for investors by protecting their capital, but they also economically assist states to develop their infrastructures.[92]

Theoretically, when a dispute arises within an investment treaty, the potential law that can be used to resolve it may be either the local law of the host state, the treaty itself or general principles of public international law.[93] Therefore, some scholars believe that the system generated by investment treaties is *sui generis*.[94] Because the investor has private interests in the success of his investment, investment treaties are a hybrid system that absorbs private law into the public sphere.[95] To put it somewhat differently, an international treaty between two sovereign states governed by international law embraces to its sphere a private dispute.[96] Some analogizes this composition of laws to a "unique marriage" or a "vertical culture clash".[97]

Although I do believe that international tax law is a hybrid system,

89. Since the beginning of the 1990's, the amount of investment treaties has been increasingly growing and amounted to 2,265 treaties in 2003. Also, during 2002, double tax treaties were over 2,000 and totaled to 2,256. *Quantitative Data on Bilateral Investment Treaties and Double Taxation Treaties*, UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT [UNCTAD], http://unctad.org/en/Pages/DIAE/International%20Investment%20Agreements%20(IIA)/Quantitative-data-on-bilateral-investment-treaties-and-double-taxation-treaties.aspx.

90. *See, e.g.*, Karen Halverson Cross, *Converging Trends in Investment Treaty Practice*, 38 N.C. J. INT'L L. & COM. REG. 151, 157 (2012); Douglas, *supra* note 3, at 201; *see also Preamble* to 2012 U.S. Model Bilateral Investment Treaty, *available at* http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf (stating that the signatory states desire to achieve greater economic cooperation with regard to investments).

91. Franck, *Legitimacy Crisis*, *supra* note 71, at 1527.

92. Franck, *The Nature and Enforcement*, *supra* note 50, at 48-49, 52-53.

93. Douglas, *supra* note 3, at 194.

94. *Id.* at 189.

95. *See, e.g.*, *id.*

96. Franck, *The Nature and Enforcement*, *supra* note 50, at 69.

97. *See* Roberts, *supra* note 70, at 54-55 and references therein.

as elaborated at the preface of this Part, I suppose we cannot adopt directly the analysis concerning investment treaties since it has some substantive dissimilarities. First, the two treaties differ in their direct and short-term goals. Obviously, the resident state signed an investment treaty aiming at protecting its resident private investments, though this interest is only indirect and depends on how this investment would eventually echo its own economy.[98] When a dispute arises the core issue is a private commercial interest.[99] Whereas, double tax treaties aim at reducing double taxation, the interest of the resident state is not directly to protect private taxpayers but to preserve the state's treasury. Second, and also very significant for our later discussion in this paper, investment treaties in many cases expressly recognize the independent procedural and substantive rights of an investor to resolve his claim in a potential dispute.[100] These similar rights for taxpayers are usually absent from double tax treaties. Third, investment treaties are not necessarily bilateral, some are multilateral,[101] while a double tax treaty is so far only a bilateral treaty. In addition, even when it is bilateral it specifically stipulates as aforesaid the parties to the disputes, *i.e.*, a dispute between the host state and the private investor *not like* in double tax treaties.

Despite the above divergence, international tax disputes are also of a special kind. International taxation is thus an amalgam of different legal fields and diverse norms that may involve the interests of conflicting states and ultimately taxpayers.

V. De Facto and De Jure Parties to International Tax Disputes

A. *Identifying Conflicting Interests and Parties*

Clearly, in an international tax dispute the taxpayer subject to double or non-taxation has a vested interest in the outcome of the dispute. Each contracting state also has an economic interest in the dispute resolution process since it is supposed to safeguard its state treasury.

In the international arena, therefore, the conflict may be tripartite — between both contracting states, and between the taxpayer and each

98. *See*, *e.g.*, Douglas, *supra* note 3, at 172.
99. *See*, *e.g.*, *id.* at 237.
100. *See* discussion *infra* notes 127-30.
101. Roberts, *supra* note 70, at 53; *see* discussion *infra* note 109.

state.[102] The conflict resolution mechanisms currently offered in the OECD Model Convention treats the problem mainly as a procedural one between states[103] and grants only the taxpayer the right to initiate procedures by: first, mutual agreement procedures where he serves only as an observer[104] and second, arbitration where he may present his case but not choose the arbitrators. The taxpayer is a participant who may submit his case in writing and can be orally heard before the arbitrators.[105] Moreover, he is not authorized to sue either state for violating or breaching a certain article.[106] To be even more precise, the arbitration process commences only when a mutual agreement process has been initiated. Recall that this process is subject to the full discretionary power of the competent authorities. In that respect, the taxpayer's role in dispute resolution is fairly passive although he is an integral part of the conflict. On the other hand, in some bilateral investment treaties taxpayers who believe that the hosting country has

102. *See* Luc Hinnekens, *Legal Sources and Interpretation of European Tax Arbitration Convention and its Recognition of the Taxpayer*, *in* RESOLUTION OF TAX TREATY CONFLICTS BY ARBITRATION 11, 25 (1994) (Hinnekens treats the dispute as "almost a tri-party procedure" and endeavors to define taxpayer's rights on the basis of the European Tax Arbitration Convention); *see also* Christians, *supra* note 51, at 1423 (Christians claims, "[i]t also demonstrates that there are several parties to an international tax dispute that have different stakes in the outcome, namely, the taxpayer and the multiple governments that have laid justifiable, if overlapping, jurisdictional claims.").

103. *See* Hinnekens, *supra* note 102, at 25 (contending that the question of taxpayer's legal position is not relevant in mutual agreement procedure but only in arbitration where the issue is not merely diplomatic but also has a jurisdictional nature).

104. "The taxpayer initiates an international tax dispute by bringing a claim to a competent authority, but it is the competent authorities alone that directly engage in the dispute and its resolution. The taxpayer is interested in having the governments resolve the problem, but once the claim has been laid, the taxpayer's role becomes one of observer, at best." Christians, *supra* note 51, at 1424.

105. *See* OECD, *Tax Treaty Disputes, supra* note 30, at ¶ 76 ("Whilst the mutual agreement procedure involves a government-to-government relation, when the process moves to arbitration, the person who presented the case is more of a direct participant. This is especially the case since the arbitration decision will be binding on each State as regards the taxation of that person. Thus, it seems appropriate that the person be able to participate to some degree directly in the arbitration process, though the process would remain under the control of the competent authorities."). Moreover, section 11 of the Annex to Article 25 Commentary titled "Sample Mutual Agreement on Arbitration" states: "The person who made the request for arbitration may, either directly or through his representatives, present his position to the arbitrators in writing to the same extent that he can do so during the mutual agreement procedure. In addition, with the permission of the arbitrators, the person may present his position orally during the arbitration proceedings". OECD, *Model Tax Convention*, *supra* note 13, at C(25)-40, ¶ 11.

106. Christians, *supra* note 51, at 1423.

compromised their investment are authorized to sue it directly.[107]

It is interesting to see that in the investment treaty arena the direct conflict is bilateral but not necessarily between contracting states. Some investment treaties treat the conflict as a conflict between the two contracting states;[108] but many others consider the conflict as a conflict between the investor of one contracting state and the host state.[109] Therefore, despite treating the second alternative as a bilateral conflict, it is a conflict between a private person and a sovereign state (the host state). Investment treaties grant investors with some substantive rights and procedural rights to "address violations of those substantive rights".[110] Investment treaty arbitration in that case is carried out between unequal parties where the investor is usually the one who initiates the arbitral procedure.[111]

B. *The Apparent Solution*

After indicating the interests of the parties at stake, we should readdress Article 25. Article 25 considers the conflict as bilateral and regulates the procedure between states.[112] Apparently, though, the proposed resolution mechanisms do not approach the conflict as it should be. First, it should be treated as trilateral and second, it should take into account the fact that encompasses elements from both public and private inter-national law (and not mainly from public international law).

The dispute is not merely a matter of contracting states disputing how to allocate revenues between them. It also involves the taxpayer (either an enterprise or an individual). Eventually it is the latter which bears the burden of double taxation.[113]

If we accept that the international tax conflict is multiform and

107. *See* Susan D. Franck, *Development and Outcomes of Investment Treaty Arbitration*, 50 HARV. INT'L L.J. 435, 435 (2009); Christians, *supra* note 51, at 1423; *see also* AVI-YONAH, *supra* note 9, at 1.

108. As referred by Douglas the "state/state sphere." *See* Douglas, *supra* note 3, at 189.

109. As referred by Douglas the "investor/state sphere." *Id*. Most treaties recognize investor rights to bring directly an arbitral claim. Roberts, *supra* note 70, at 50.

110. *See* Franck, *Legitimacy Crisis*, *supra* note 71, at 1529; Roberts, *supra* note 70, at 60.

111. *See* Anna T. Katselas, *Do Investment Treaties Prescribe a Deferential Standard of Review?*, 34 MICH. J. INT'L L. 87, 89 (2012).

112. *See* Lindencrona, *supra* note 38, at 5.

113. *See* Hinnekens, *supra* note 102, at 11.

carries elements from both international and national law and from both public and to some extent private international law, we have to examine whether the taxpayer has standing in each legal field. In other words, the question is whether the taxpayer has the "right to make a legal claim or seek judicial enforcement of a duty or right".[114]

Needless to say, if we consider the tax conflict as a domestic or private international law conflict, then a taxpayer has standing — he can easily demonstrate that he will suffer financially if the dispute resolution outcome does not redress double taxation. In both legal fields, individuals have private interests in the matter and can bring their case before national courts. Naturally, after meeting some procedural requirements taxpayers can sue the tax authorities in domestic courts. The problem may arise in public international law, however.

Recall that double tax treaties also carry elements of international law. Although individuals have some role to play in international law, traditionally its subjects have been only states. Gradually the scope of subjects of international law has been growing. Especially after World War II new actors entered into the international arena.[115] As a result, modern public international law recognizes that individuals may be also independent subjects thereof.[116] This means that individuals have legal personality in international law, mainly, though not exclusively, in the human rights area.[117] We may thus conclude that in both legal fields at stake — the national and international — the taxpayer has certain rights to be heard.

This conclusion is, however, somewhat misleading since the scope of individual rights and obligations in the international sphere is somewhat limited. It should be emphasized that I do not claim that in international law there is complete overlap between being a subject and being a court party of international law. Still in the international field,

114. See BLACK'S LAW DICTIONARY 1536 (9th ed., 2009) for definition of "standing".

115. *See* Janis, *supra* note 85.

116. *See* MALCOLM N. SHAW, INTERNATIONAL LAW 197 (6th ed. 2008) (As Shaw states "[p]ersonality in international law necessitates the consideration of the interrelationship between rights and duties afforded under the international system and capacity to enforce claims…. International personality is participation plus some form of community acceptance.").

117. *See, e.g.*, *id.* at 258; *see also* Marek St. Korowicz, *The Problem of the International Personality of Individuals*, 50 AM. J. INT'L L. 533, 535 (1956) (claiming that "[t]he subjects of international law may be defined as persons to whom international law attributes rights and duties directly and not through the medium of their states.").

not only are individuals not always able to sue,[118] but in many cases even the case cannot be brought by other parties to any international court. Nevertheless, as already mentioned, this tendency is changing mainly in the human rights area, where it would seem that individuals are increasingly considered to have both obligations and rights deriving from general international rules.[119] In some instances individuals can even take the case directly to court. This has been possible since the 1998 European Convention on Human Rights, which authorizes individual victims to sue the violent member state in the European Court of Human Rights.[120] Since the court's establishment more than 10,000 judgments have been given[121] (this individual right to sue is also granted before the African Court of Human and Peoples' Rights).[122] Some claim that this progress should also expand to obligations in civil international law.[123] It should be noted, that some scholars believe that individual's independent standing in investment disputes derives from the field of human rights.[124]

Since the inclination in international law is to expand individual rights and since there is a growing tendency to recognize individual rights in international sphere, one can claim that this tendency should be expanded also to international tax law.

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118. As Shaw notes "[i]ndividuals as a general rule lack standing to assert violations of international treaties in the absence of a protest by the state of nationality, although states may agree to confer particular rights on individuals which will be enforceable under international law, independently of municipal law." SHAW, *supra* note 116, at 258.

119. *See* Andrew Clapham, *The Role of the Individual in International Law*, 21 EUR. J. INT'L L. 25, 27 (2010).

120. *See* Convention for the Protection of Human Rights and Fundamental Freedoms art 34, Nov. 4, 1950, Europ.T.S. No. 5; 213 U.N.T.S. 221. ("The Court may receive applications from any person, non-governmental organisation [*sic*] or group of individuals claiming to be the victim of a violation by one of the High Contracting Parties of the rights set forth in the Convention or the Protocols thereto. The High Contracting Parties undertake not to hinder in any way the effective exercise of this right.").

121. Over 150,000 applications have been brought before the judicial formation (the pre-judicial stage). *See In Facts and Figures 2011*, EUR. CT. HUM. RTS. (Jan. 2012), *available at* http://www.strasbourgconsortium.org/content/blurb/files/FAITS_CHIFFRES_EN_JAN2012_VERSION_WEB.pdf.

122. The court was officially founded in 2006 by virtue of the Protocol of the African Charter on Human and Peoples' Rights on the Establishment of an African Court on Human and Peoples' Rights. *African Court in Brief*, AFRICAN COURT OF HUMAN AND PEOPLES' RIGHTS, http://www.african-court.org/en/index.php/about-the-court/brief-history. The Court is bound to protect the rights adopted by the African Charter on Human and Peoples' Rights. *Id.; see also*, Clapham, *supra* note 119, at 28.

123. Clapham, *supra* note 119, at 28.

124. *See, e.g.* , Douglas, *supra* note 3, at 185-86.

This conclusion receives wide support from the investment treaty literature, which bears some similarities to double tax treaties.[125] It is claimed that since investment treaties carry elements from both international and national law and private and public law it creates a new unique system.[126] When a dispute arises within the investment treaty scope, one can differentiate between two spheres: a conflict between two states or a conflict between a state and a private investor.[127] Today, investment treaties assign investors a direct and independent right in international disputes. In the private-state sphere the investor is a direct party with full standing in the dispute resolution.[128] If the host state did not fulfill its obligations and damaged his investment, the investor has a personal right to bring a claim against the tortfeasor, *i.e.*, the host state. The investor here is analogized to a "private attorney general"[129] since a private person from the resident state may carry out by himself an international dispute against the host state.[130]

In the short run we saw that the individual taxpayer has incentives to be party to the dispute. He has an incentive to be heard and influence the outcome. In the long run it is not simply the interest of the specific taxpayer but also of potential future taxpayers who may face a similar double taxation problem. Ignoring the taxpayer's direct interests in this conflict may deter some businesses from carrying on international

125. Though the two kind of treaties also differ from each other see the discussion *infra* note 97.

126. *See, e.g.*, *id.* at 185-86, 189, 193; Roberts, *supra* note 70, at 50 (In this article, Roberts criticizes the common paradigms in investment treaty analysis. In order to understand the nature of investment treaties, it is common to compare it to other legal fields. The ordinary analogies are taken for example from public international law, international commercial arbitration law, domestic public law (including administrative and constitutional laws) and international public law (including human rights and trade law). Each of them has pros and cons in analyzing investment treaties. These paradigms do not fall in line and in many instances collide due to different structure, assumptions and inherent norms).

127. Douglas, *supra* note 3, at 189.

128. *See, e.g.*, Asha Kaushal, *Revisiting History: How the Past Matters for the Present Backlash Against the Foreign Investment Regime*, 50 HARV. INT'L L.J. 491, 498 (2009). Kaushal reviews the historical development of investment treaty arbitration. Kaushal reveals that states gave up their sovereignty in order to enhance investor rights and property rights. Kaushal argues that this outcome blurred the distinction between national and international law and between private and public law. *Id.* at 514-23. Additionally, Kaushal claims that this blur between the private and the public sphere caused part of the public sphere to privatize and thus to reduce private rights. *Id.* at 519-32.

129. *See*, Franck, *Legitimacy Crisis*, *supra* note 71, at 1538.

130. *Id.*

economic activity. Protecting the individual taxpayer should concern both contracting states, as both are interested in promoting economic growth and efficiency. The remaining question is whether we need to treat him as a party to do so.

C. *The Normative Solution*

So far I assumed the taxpayer has a legitimate interest to be heard in the "international" dispute. In other words, I assumed he is a third active party. From an institutional perspective he is a third party and naturally the resolution impacts him primarily and directly. Accordingly, he should have full standing since his rights are recognized and protected not only in national law where he can sue tax authorities but also within the scope of international law. This analysis was based on the presumption that double tax treaties are amalgam of various legal fields. But does he really have standing? Some scholars believe that due to the extraneous interests of the business community he is a "non-party" and should be only an observer.[131] The OECD proposal addresses this question too, stating that the taxpayer should participate in the arbitration process though the process will only be conducted by the signatory states.[132] I too believe that in many cases he should not appear before the court as a third interested party, but my reasoning differs.

It is true that international tax conflicts involve hybrid characteristics of both national and international law. The discussion so far excluded a normative perspective. The approach was institutional, assuming that since an individual can be party to a dispute in both international and national law and since he naturally has an interest in the outcome, he should have standing. Both legal spheres support and recognize the private rights of a person – the taxpayer.

However, if one introduces to the international tax discourse equitable rationales well established in legal tradition, the apparent solution will no longer be valid. If we introduce the discourse of principles and if the overarching objective is to prevent double taxation and even double non-taxation, we will reach a different conclusion where a taxpayer has no say in the dispute.

The first task is to present the relevant international principles. One

131. *See* McIntyre, *supra* note 35, at 639-40.
132. *See supra* note 103 and accompanying text.

major principle governing international law is good faith,[133] as articulated in Article 2(2) of the United Nations Charter.[134] This principle is elaborated[135] in the Declaration on Principles of International Law Concerning Friendly Relations and Co-Operation among States.[136] Thus, the principle of good faith should be applicable to meeting an existing obligation.[137]

The principle derived from the above declaration is the duty of states to cooperate. Although this duty is broad[138] it can highlight the duty of contracting states to negotiate in the case of the mutual agreement process discussed above. It can guide the contracting states not only to negotiate but also to endeavor in good faith to cooperate and reach a conclusion. Another international principle is the equity principle introduced by international courts;[139] although, "[e]quity has been used by the courts as a way of mitigating certain inequities, not as a method of refashioning nature to the detriment of legal rules."[140]

The good faith and equity principles are relevant to the discussion here. Good faith is a vague concept that defies straightforward definition. Since it is an equitable principle,[141] though, I will refer to both jointly as "the outer equitable principle".

In the private arena and more specifically in the domestic tax field, the equity principle was interpreted as the ability-to-pay principle. Although not controversial per se,[142] the contents of equity under tax law attracted significant attention in the literature. The prevailing principle

133. SHAW, *supra* note 116, at 103-04.

134. UN Charter art. 2, para. 2 ("All Members, in order to ensure to all of them the rights and benefits resulting from membership, shall fulfill in good faith the obligations assumed by them in accordance with the present Charter.").

135. SHAW, *supra* note 116, at 104.

136. G.A. Res. 2625 (XXV), U.N. GAOR, 25th Sess., Supp. No. 28, U.N. Doc. A/8028 (Oct. 24, 1970).

137. SHAW, *supra* note 116, at 104.

138. VAUGHAN LOWE, INTERNATIONAL LAW 111 (2007).

139. SHAW, *supra* note 116, at 105-07.

140. Moreover, "[i]ts existence, therefore, as a separate and distinct source of law is at best highly controversial." *Id.* at 107.

141. In explaining the concept of "good faith" under Section 205 of the Restatement (Second), Summers suggests that this concept ". . . is of a piece with explicit requirements of 'contractual morality' such as the unconscionability doctrine and various general equitable principles." *See* Robert S. Summers, *General Duty of Good Faith – Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810, 811 (1982) (footnotes omitted).

142. *See, e.g.*, LIAM MURPHY & THOMAS NAGEL, THE MYTH OF OWNERSHIP 12 (2002).

applied both in scholarly discussion and in practice, [143] designed to accomplish the equity goal, is the ability-to-pay principle.[144] The essence of this principle is that tax liability should follow individual well-being. A well-off person should pay more taxes than a poor person. Utilitarian views tried to conceptualize the ability-to-pay principle[145] in at least two ways.[146] First, a person with higher income can pay more taxes since his marginal utility from money diminishes. Second, a person with high income is able to sacrifice a larger portion of his income, since he simply has more to spend than the poor. The ability-to-pay principle was interpreted into tax law by progressive tax rates – people with higher income are subject to higher tax rates. Thus, the principle should guide policy makers in designing tax rules, and as it reflects equitable treatment among taxpayers, I refer to it as the "inner equitable principle".

If one seeks to accomplish an equitable result according to both the outer and inner equitable principles, the taxpayer should not have a "de jure standing". The analysis rests on the assumption or even the axiom that contracting states are obliged to reduce double taxation and trusted to act accordingly. As explained in the foreword to the OECD Model the main aim of bilateral double tax treaties is to overcome the well-known distortive effect of double taxation in international transactions. And as stated, "[t]his is the main purpose of the OECD Model Tax Convention on Income and on Capital, which provides a means of settling on a uniform basis the most common problems that arise in the field of international judicial double taxation."[147]

An example can clarify this claim. Let us assume that person X, a citizen and resident of state X, generates income in state Y. Both states have signed a double tax treaty based on the OECD Model. If State X applies the residence-based regime and State Y does not exempt income produced in its territory from tax, a classical double taxation problem will arise. Let us moreover assume that this is a case of full double

143. For the prevalence of the ability-to-pay principle, see *id.* at 20.

144. *See, e.g.*, JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES: A CITIZEN'S GUIDE TO THE DEBATE OVER TAXES 61-66 (4th ed. 2008).

145. John G. Head, *Tax-Fairness Principles: A Conceptual, Historical, and Practical Review, in* FAIRNESS IN TAXATION 10 (Allan M. Maslove ed. 1993).

146. MURPHY & NAGEL, *supra* note 142, at 24.

147. See OECD, *Model Tax Convention, supra* note 13, at I-1, ¶ 3 and RICHARD E. ANDERSEN, ANALYSIS OF UNITED STATES INCOME TAX TREATIES ¶¶ 1.01-1.01[1] (2013), which states that there are two main purposes for double tax treaties. The first is to overcome the double tax problem to facilitate cross border trade and the second to enable the contracting states to enforce tax collection.

taxation. For simplification, we can also assume that the income incurred is one hundred dollars and the tax rate on this income in each state is a flat tax of thirty percent. So his tax liability in each state is thirty dollars. Therefore cumulatively he will be required to pay sixty dollars in tax (meaning paying the tax twice). Applying the inner equitable principle means that it is inequitable to tax the taxpayer twice for the same income. Moreover, if states are fully committed to cooperating and eliminating double taxation and implementing the outer equitable principle, the taxpayer has nothing to contribute. If both countries in my example are compelled to reduce double taxation and divide between them thirty dollars — the taxpayer has nothing to contribute to the discussion. It is merely a conflict between the contracting states on how to allocate the tax among them, with the proviso that the taxpayer should be taxed only once according to the inner equitable principle, *i.e.*, to his ability to pay.

If the case at stake is not a double taxation but rather a double *non*-taxation case the analysis should remain the same. If a taxpayer structures his transaction in a manner that takes advantage of the different tax rules of state X and Y he may benefit from low taxes or even avoid taxation altogether (*i.e.*, double non-taxation). This tax arbitrage also means that the taxpayer is not taxed with accordance to his ability and that states should determine between themselves (perhaps with the help of arbitrators)[148] how to fully tax him and allocate his liability between them. Here again, the relevant parties are only the contracting states. The problem that may arise, though, is that according to the current OECD model, the taxpayer is the only one empowered to launch the arbitral process. Since, as I claim, he has no de jure standing, the taxpayer should be deprived of the right to initiate the arbitral process, which should be left to the contracting states.

To conclude, each state is obliged by its own jurisdiction and norms to implement the inner equitable principle; each state is also obliged to implement the outer equitable principle when the state is party to an international case. Since international tax disputes carry both national and international elements, both principles should be employed. If the tax dispute reaches a MAP then the contracting states ought to follow those principles by themselves. If, on the other hand, the conflict reaches international arbitration or judiciary this task is left to either the international arbitrators or the judges. In any case, due to its hybrid nature, the international tax conflict should be resolved according to both

148. For the advantages of arbitration, see *supra* Part III.C.

the inner and outer equitable principles. The discussion so far stipulates the parties to the dispute, though has been salient with regard to the proper dispute resolution mechanism.

VI. Food for Thought

The foregoing discussion suggests one recommendation. After arguing that a taxpayer's active participation in an international tax dispute resolution process is unnecessary I could have stopped at that. The other (state) parties required to uphold the normative equity principle could reach a proper resolution. However, you may recall the discussion in an earlier part where I compared the pros and cons of arbitration relative to MAP and the judicial process. If we ignore the technical (though not unimportant) matter of financing a tax tribunal (or even a permanent arbitrator panel) and after comparing the various international tax conflict resolution mechanism and taking into account the hybrid character of international taxation, I believe that a body composed of tax experts is the preferable dispute resolution mechanism. I believe that such a body could better implement the tax norms (including the inner and the outer equitable principles) than representatives of the tax authorities of the contracting states in an MAP.

Accordingly, a body composed of tax experts — either a tax tribunal or an arbitrator panel – is preferable to MAP. But could we argue in favor of one of the bodies? Could we tip the scales in the lengthy discussion in favor of one of the above-mentioned mechanisms? Recall the former characterization of international taxation. Part IV discussed the hybrid elements of international taxation. Apparently, this classification contributed to my discussion by examining the taxpayer's active participation in dispute resolution. The apparent solution indicated that the taxpayer should be an active participant in the process; however, this apparent solution was overruled by the normative analysis. But if I return to the question that has troubled many scholars — which dispute resolution mechanism is preferable for resolving international tax conflicts — the analysis should lead in the opposite direction. If I ignore for the sake of discussion the taxpayer's participation in the process and focus only on the arbitration-versus-adjudication issue, then the normative aspect so vital to my analysis will lose its relevance. If we are dealing with tax experts — either arbitrators or judges — who are able to internalize the equity principle in their ruling, then both are equally qualified from a normative perspective and the normative analysis loses

its relevance. The technical solution, however, based directly on the hybrid form of international taxation can shed further light on the discussion and favor a permanent tribunal (rather than an ad-hoc arbitration).[149] A permanent tribunal can enhance the international quality of international taxation by developing customary law and as a byproduct promote tax harmonization. An ad-hoc body that also does not disclose its decisions cannot produce and uphold international tax law.[150]

VII. Conclusion

After briefly noting the hybrid elements of international tax treaties, I discussed the normative question. How should we resolve disputes when a double tax treaty does not help a taxpayer avoid double taxation and both contracting states insist on their complete share? I suggest that this normatively hybrid legal field deserves a different analysis to resolve the conflicting private and national interests involved. I believe that the response to this question is crucial for identifying the genuine parties to cross-border tax disputes. The typical international tax dispute is tripartite in that it involves the interests of both contracting states and the taxpayer. After identifying the tripartite nature of such disputes and noting that both international and national law safeguard individual rights the apparent solution would seem to be that the individual taxpayer should be party to the dispute.

However, this is not a well-founded solution since it is only procedural and lacks normative insight. When one considers also the normative aspect, the apparent solution is no more valid. The normative discussion is guided by equitable norms accepted both in international and national law. If one accepts that the primary goal of double tax treaties is indeed to eliminate or at least reduce double taxation and if states are trusted to accomplish this objective, then active taxpayer participation in resolving the international tax dispute becomes unnecessary. Thus, to conclude, if indeed dispute resolution aims at

149. This recommendation absorbs one feature from the proposal stipulated by Franck with regard to investment treaties: the body's *permanency*. Franck supports the "establishment of an independent, permanent appellate body with the authority to review awards rendered under a variety of investment treaties." Franck supports the arbitration process but suggests a permanent appellate body. *See* Franck, *Legitimacy Crisis*, *supra* note 71, at 1525, 1617-25.

150. See the fairness argument discussed *supra* Part III.C.

preventing double taxation (or non-taxation) the genuine parties are only the signatory states.