CHAPTER 23

International Tax Arbitration as an ADR Solution in a Time of Global Tax Demands

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Business transactions in the current global economy are inevitably expanding across national borders, as horizontal and vertical integration becomes the most efficient way of achieving profits in mass production of goods and services. The involvement of an increasing number of jurisdictions in day-to-day transactions, and the complexity of business models (especially in the financial and services industries) have brought new difficulties in determining which country has a legitimate right to tax the profits, and, conversely, which country must accept the deduction in case the transaction results in a tax loss.

In some cases, businesses have profited from these difficulties, creating sophisticated tax planning structures that take advantage of mismatches in the domestic tax legislation of each of the countries involved and the lack of information in most countries regarding the global allocation of profits for multinationals. In other cases, the existence of beneficial tax regimes created in domestic legislation and tax treaties has facilitated aggressive tax planning that artificially allocates profits to low-tax regimes while attributing losses to high-tax jurisdictions. In a large number of cases, however, taxpayers have legitimately claimed domestic or treaty benefits that have reduced their global tax burden, and the distinction between these cases and the illegitimate aggressive tax planning is unclear.

As the OECD has pointed out in the Base Erosion and Profit Shifting (BEPS) report, these challenges can only be addressed through global cooperation between States (OECD, 2013b), consisting in the enforcement of agreed international tax standards aimed at protecting national revenues from artificial profit shifting strategies. These international standards already include automatic Exchange of Information, which was materialized in the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters, signed by 66 States in July (OECD, 2014). Further to this, the OECD is working on an action plan that will develop “international instruments that will better align rights to tax with economic activity” (OECD, 2013a). These standards

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could be eventually included in a multilateral convention (OECD, 2013a), which also includes a recommendation to implement international tax arbitration to enhance dispute resolution in modern international tax conflicts.

Indeed, dispute resolution mechanisms in international tax conflicts are already suffering a crisis, as the traditional Mutual Agreement Procedure (MAP) still leaves several cases unsolved with double or multiple taxation for the taxpayer (Nowland, 2014). The MAP, as we will discuss further on, has two significant limitations as a dispute resolution mechanism: it is only applicable in the context of a treaty and the obligations agreed therein, and it does not provide an obligation for competent authorities to reach a solution (Bertolini, 2013). As the international tax dispute resolution crisis deepens and a new international tax architecture begins to surface, it is key to develop new truly international mechanisms that will be effective and inclusive for developing countries, which are increasingly becoming involved in important international tax disputes (Mahajan, 2014) and now play a very important role in the framework of global transparency and cooperation (Moore, 2014).

This article will discuss the convenience of adopting international tax arbitration as the prime dispute resolution mechanism for international tax disputes in the current cross-border economy, while providing guidelines to address the concern of establishing a leveled ground for the implementation of arbitration in disputes involving developing countries. Such guidelines will be developed in the context of ‘transitional tax justice’ (Cruz-de-Quinones, 2014) that includes developing countries in the solution while taking into account their particular needs during a period of adjustment to the new mechanism for enforcing international tax standards and resolving international tax disputes.

Current Dispute Resolution Mechanisms and Developing Countries

The prevailing mechanism for resolving international tax disputes in the world is the Mutual Agreement Procedure (MAP) contemplated in most Double Taxation Agreements (DTAs). The MAP is based on the undisclosed agreements reached in good faith by the competent authorities of two or more countries in private meetings without any taxpayer participation. As mentioned above, the MAP has two fundamental flaws that have undermined its capacity to resolve international tax disputes: it is limited to the conflicts arising from particular treaties as established in the treaty clause, and it does not provide an obligation to reach an agreement. Furthermore, the outcome of MAP does not constitute precedent and is usually undisclosed to the public, creating an absolute absence of case law in the practice of international tax