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Would Actions 14/15 improve the judicial protection of taxpayers in the EU?

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The transition from bilateralism to multilateralism in regard of international law-making seems to be a relentless work in progress. Nobody contests that multilateralism would be – legally speaking – preferable. On the other hand, the governments of the G20 have been constantly hesitant regarding a multilateral surveillance of their macroeconomic policies. Formally, the treaties are signed on a bilateral basis, but they follow a preconceived formula and fall within the scope of common rules developed in practice. It has been argued in doctrine that the practice of model-conform bilateral agreements has generated a new kind of multilateralism – a so-called implicit multilateralism – that is characterised by the fact that regardless of who the signatories of a specific agreement are, the agreed provisions are almost identical[1].

The OECD itself may be seen as the symbol of escaping multilateralism. Therefore, the recent moves towards a more unified law adopted on a multilateral basis may – at least at first sight – appear intriguing. The OECD/G20 Project concerning Base Erosion and Profit Shifting (BEPS) includes Action 15 that calls for the modification of bilateral tax treaties and the introduction of a multilateral treaty in order to swiftly implement the tax treaty measures developed in the course of that project. Action 14 of the project deals with the judicial protection of taxpayers' rights and recognises the necessity to introduce an effective procedural framework in order to address the problem of prevention and timely resolution of treaty-related disputes.

The European Commission argued contrariwise that the implementation of the BEPS Actions 14/15 alone would not constitute sufficient action to ameliorate existing dispute resolution mechanisms and it would interfere with the uniform application of the provisions of the EU Convention 90/463/EEC ('Arbitration Convention')[2]. Six EU Member States are not even direct participants in the BEPS project. The European Commission considers that only a Directive would be fit for the challenge of improving double taxation dispute resolution within the EU.

In short about the Arbitration Convention

The EU Arbitration Convention that entered into force in 1995 is the result of a political compromise. It holds the name 'Convention', because the name 'Directive' would bear a negative connotation vis-à-vis the incontestable fiscal autonomy of the Member States. It relies on the concept of PE ('distinct and separate enterprise dealing independently') and the arm's length principle (conditions made or imposed between associated enterprises in their commercial or financial relations shall be equivalent with the ones made or imposed between independent enterprises) as central criteria used to determine which Member State has the jurisdiction to impose taxation on income. Its scope is limited to the adjustment and attribution of profits among associated enterprises.

The exhaustion of domestic remedies is not an explicit condition. '*Enterprises may have recourse to the remedies available to them under the domestic law of the Contracting States concerned*'. However, if the tax authorities initiated proceedings against the enterprise in question, the complaint procedure started under the Arbitration Convention might be suspended until the finalisation of the administrative or penal proceedings. If the domestic proceedings have a punitive character, the taxpayer would have to pay the penalties in spite of the submitted complaint under the Arbitration Convention. The fact that the taxpayer must pay first and then fight to recover the sum required in breach of Article 4 of the Convention is prone to have a discouraging effect. If the Convention had been a Directive – as it was meant in the beginning – the EU legal principles of equivalence and effectiveness would have precluded the lack of interim relief in conformity with the *Unibet* jurisprudence.

Moreover, in order to avoid parallel proceedings that may lead to conflicting results, the exhaustion of domestic remedies may be required in practice. If the taxpayer uses the domestic remedies and reaches on this path the court of final resort, the access to arbitration might be denied, where the applicable domestic law does not permit the competent authorities to derogate from the decisions of their judicial bodies. The same rule applies according to the provisions of Article 25 of the OECD Model (2014).

> These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State[3].

A public consultation launched by the European Commission in 2010 revealed that the Arbitration Convention and the DTCs that included an arbitration clause have been ineffective in solving double-taxation disputes[4]. One of the major problems has been the lack of involvement of the taxpayer. The competent authority can declare the request to be invalid or refuse to deal with the request and no legal remedies can be used against such decision. Furthermore, if the request is deemed valid, the MAP will be conducted government-to-government usually in the absence of the concerned taxpayer.

The 'threat' of arbitration is not persuasive enough. The MAP is not verifiable, thus the solutions produced by it are not legally certain. The decision to move forward to the arbitration stage is fully controlled by the governments. Arbitration is thus a voluntary choice. However, the arbitration clause introduced in the 2007 OECD Model Convention stipulates mandatory arbitration, if the competent authorities are unable to find a solution during the MAP. On the other hand, according to article 12 of the Arbitration Convention, the decision of the advisory commission is not binding upon the competent authorities. They can still agree to set aside the arbitral decision and find an alternative solution that eliminates double taxation. It appears obvious that bilateralism still matters, since arbitration will be obligatory and binding, only if it has been established so on a bilateral basis.

In order to address the shortcomings of the double taxation dispute resolution mechanism in the EU, the European Commission has projected in February 2016 the adoption of a directive that would replace the Arbitration Convention[5]. In this case, the CJEU will have jurisdiction to interpret the provisions establishing a common procedural framework and the EU Charter of Fundamental Rights will become fully applicable as well.

Even more exciting is the fact that the European Commission pursues a similar change of view in regard of international investment law. On 18 June 2015 the European Commission requested a number of EU Member States to terminate their intra-EU BITs arguing that these agreements conferred rights on a bilateral basis, thus not ensuring the observance of the principle of non-discrimination on grounds of nationality[6]. The Commission held that the bilateral investment treaties signed between Member States are not compatible with the Union law. The incompatibility refers to discrimination both in terms of substantive rights and their judicial protection, since the access to a dispute settlement mechanism puts the investor covered by such a clause in a more favourable position[7].

Concerning the latter, the Bundesgerichtshof lodged a recent request for a preliminary ruling on the interpretation of the principle of equal treatment enshrined in Article 18 TFEU in relation to the special entitlement of an investor to bring proceedings against a contracting state before an arbitral tribunal[8]. The possibility to circumvent the system of domestic remedies solves the problem of prevention and timely resolution of treaty-related disputes, but it may raise new complications in relation to the autonomy of EU law. This case is still pending before the CJEU.

In short about Actions 14/15

Action 14 of the BEPS is based on a compromise. It contains an agreement on a minimum standard, non-compulsory best practices and a monitoring mechanism. There is still no consensus among all OECD and G20 countries on the adoption of mandatory binding arbitration as a mechanism to ensure the timely resolution of MAP cases. The minimum standard contains three rather fuzzy duties that require no more that the countries should respect the already agreed obligations[9].

- Countries should ensure that treaty obligations related to the MAP are fully implemented in good faith and that MAP cases are resolved in a timely manner;
- Countries should ensure that administrative processes promote the prevention and timely resolution of treaty-related disputes; and
- Countries should ensure that taxpayers that meet the requirements of paragraph 1 of Article 25 can access the MAP.

The 2007 OECD Report entitled ‘Improving the Resolution of Tax Treaty Disputes’ names the possible conflict between the OECD standard and the EU Arbitration Convention.

> States which are members of the European Union must co-ordinate the scope of paragraph 5 with their obligations under the European Arbitration Convention.

Action 15 contemplates the majesty of the current network of DTCs. A similar structure has been created in the field of international investment law, where the BITs follow a network-pattern. Action 15 claims that a multilateral convention will improve the legal certainty and ensure a more consistent interpretation and coherent application of tax treaty law, thus increasing the reliability of the DTC-network. However, the multilateral instrument will be applicable as a complementary set of rules coexisting with the DTCs. The DTCs would remain in force for all non-BEPS related issues, that's to say that the multilateral treaty will constitute *lex specialis* overriding the provisions of the applicable DTC in relation to BEPS issues. This means that the rules preventing double non-taxation would override the rules preventing double taxation. The doctrine "*lex posterior derogat legi priori*" would lead to the same conclusion. Actions 14/15 may sound promising, but are they prone to deliver the expected results?

The possible conflict between the EU supranational law and the OECD-modelled dispute resolution system

Most scholars would agree on the fact that the system of arbitration in relation to double taxation disputes must be compulsory, so the states involved would have to reach a deal preferably during the MAP phase. The second aspect on which most commentators agree is the involvement of the taxpayer and the composition of the body of arbitration. Lack of transparency in combination with the dominance of the political over the legal will generate fragmentary and unpredictable solutions to a small number of double taxation disputes that reach the arbitration phase.

In contrast, the framework for international investment law has been proven to be effective in addressing the issue of unfair treatment in investor-to-state disputes. The access as a party to arbitration is guaranteed for the investor. However, even in this case where the system of arbitration relies on a multilateral platform (the ICSID or NY Convention) and the investor is directly involved in the dispute resolution proceedings, the bilateralism still rears its ugly head. The actual problem is the isolation of the system of arbitration, its only channel of communication with the EU being the institution of *amicus curiae* that allows the Commission to participate in an arbitration as representative of the Union's interests. The institution of *amicus curiae* has been proven unsuccessful in correcting the lack of uniform application of Union law in the framework of arbitration of international investment law disputes.

The most interesting aspect of the proposed analogy is that the taxpayer is also an investor whose protection is ensured under the BIT-network. Therefore, the taxpayer has often – depending on the factual situation – a choice to bring an international investment dispute before an arbitral tribunal instead of submitting a double taxation complaint to the attention of competent authorities. In general, the grant of specific tax benefits – exemption or reduction or favourable tax ruling – are regarded as an agreement falling under the rule *pacta sunt servanda*.

On the other hand, the grant of tax benefits is caught under the radar of the EU State aid control with all the consequences well-known from the recent Commission cases[10]. In, conclusion, the competence to grant and withdraw tax benefits does no longer belong to an intact field of tax autonomy, at least in the case of EU Member States. So, how wise would be – even politically speaking – to continue working on the patch blanket of rules and regulations and multiply the number of overlapping areas? The reliability of the system of justice will be ultimately at stake.

The regulatory overlap between the intra-EU bilateral treaties and the EU legislation gave rise to a series of conflicts. The Commission argued that the intra-EU BITs do not ensure equal protection to investors from all EU Member States and provide for parallel possibly divergent jurisprudence under arbitration procedures[11]. The lack of equal protection has been regarded by the Commission as discrimination based on nationality and deemed incompatible with Union law. Can such regulatory overlap occur between the intra-EU DTCs and EU law?

Consistency is key

Member States must exercise their competence in the area of direct taxation consistently with EU law and, in particular, with the fundamental freedoms guaranteed by the Treaty. In the absence of harmonisation at EU level, the disadvantages that could arise from the parallel exercise of tax competences by different Member States, to the extent that such an exercise is not discriminatory, do not constitute restrictions on the freedom of movement and, moreover, the Member States are not obliged to adapt their own tax systems to the different tax systems of other Member States, in order inter alia to eliminate double taxation[12].

The fact that those reciprocal rights and obligations apply only to persons resident in one of the two Contracting Member States is an inherent consequence of bilateral double taxation conventions[13]. Hence, the Member States may find inspiration in international practice and, particularly, the model conventions drawn up by OECD[14]. The scope of a bilateral tax convention – no matter if it is signed with a third country or a Member State[15] – is limited to the natural or legal persons defined by it. Likewise, the benefits granted by it are an integral part of all the rules under the convention and contribute to the overall balance of mutual relations between the two contracting States[16].

Conversely, the distinction between residents and non-residents for tax purposes does not justify a difference of treatment if the non-resident receives almost all income from the Member State in question[17]. The distinction was irrelevant also in the case of shareholders receiving the benefit of a concession granted to a fiscal investment enterprise on account of tax deducted at source by another State from dividends received by that enterprise. The reduction of the concession for foreign tax in proportion to the shareholdings held by persons who are resident or established in another Member State adversely affects all that enterprise's shareholders without distinction, since it has the effect of reducing the amount of net profit available for distribution. The benefit of such concession has to be extended to cover the fiscal enterprises with shareholders who were not resident or not established in that Member State[18]. This solution reminds of the Bundesgerichtshof's opinion in Achmea[19].

According to State aid law, benefits of general application fall outside the prohibition prescribed by Article 107(1) TFEU. Moreover, the State aid prohibition makes no distinction between benefits granted to residents and non-residents under different tax treaties, but it only focuses on the concept of economic advantage that comes about whenever the domestic fiscal legislation or its application in practice departs from the common rules of taxation. Therefore, inconsistency in the application of law provides in itself an indication of taking a step aside the 'normal' taxation rules[20]. As a result of that, even a mutual agreement or an arbitral decision that deviates from the normal course of application of general taxation rules can confer a benefit that constitutes State aid.

Hence, the only kind of dispute settlement mechanism that can ensure legal certainty for the taxpayer in the EU is one that eliminates the possibility of inconsistent application of taxation rules and gradually replaces the patch blanket of options with a reliable common body of case law. OECD's pampering seems to reinforce fears of imagined consequences of failing to cope with multilateralism and risks to deprive the EU Member States of the opportunity to act in a manner reflective of genuine responsibility.

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[1] García Morales, M. J.; Montilla Martos, J. A.; y Arbos Marín, X., 2006. Las relaciones intergubernamentales en el Estado autonómico. Madrid: Centro de Estudios Políticos y Constitucionales, p. 18

[2] Available at (click here)

[3] See also 2007 OECD Report 'Improving the Resolution of Tax Treaty Disputes': '*Where the domestic legal remedies are first pursued and are exhausted in a State, a person may only pursue the mutual agreement procedure in order to obtain relief of double taxation in the other State*'

[4] 2010 Consultation on Double Taxation Conventions and Internal Market

[5] 2016 Consultation on Improving double taxation dispute resolution mechanisms

[6] IP of 18 June 2015 available at http://europa.eu/rapid/press-release_IP-15-5198_en.htm

[7] Commission Decision 2015/1470 of 30 March 2015 on State aid SA.38517, points 110-112

[8] Case C-284/16, Slovak Republic v Achmea BV, pending

[9] Model Tax Convention on Income and on Capital 2014 (Full Version)

[10] *Inter alia* Commission State aid Cases in Apple/Ireland, Amazon/Luxembourg, FIAT/Luxembourg, Starbucks/Netherlands, Micula/Romania, Mc Donald's/Luxembourg, GDF Suez/Luxembourg

[11] European Commission, Monitoring activities and analysis, Bilateral Investment Treaties between EU Member States (intra-EU BITs) 2012

[12] Case C 48/15 SPF Finances v ING International EU:C:2016:356 paragraphs 43, 47

[13] Case C-376/03 D v Inspecteur van de Belastingdienst EU:C:2005:424 paragraph 61. Compare with Commission Decision in Micula, supra footnote 7

[14] Case C-470/04 N v Inspecteur van de Belastingdienst Oost EU:C:2006:525 paragraph 45

[15] Compare with case law on the interpretation of Article 351 TFEU, where a clear distinction has been made between intra and extra EU-treaties

[16] Case C 176/15 Riskin EU:C:2016:488 paragraph 31

[17] Case C-520/04 Turpeinen EU:C:2006:703 paragraph 39

[18] Case C 194/06 Orange European Smallcap Fund EU:C:2008:289 paragraph 82

[19] See supra footnote 8

[20]2 Joined cases C-106/09 P and C-107/09 P Gibraltar EU:C:2011:732 paragraphs 90 and 145

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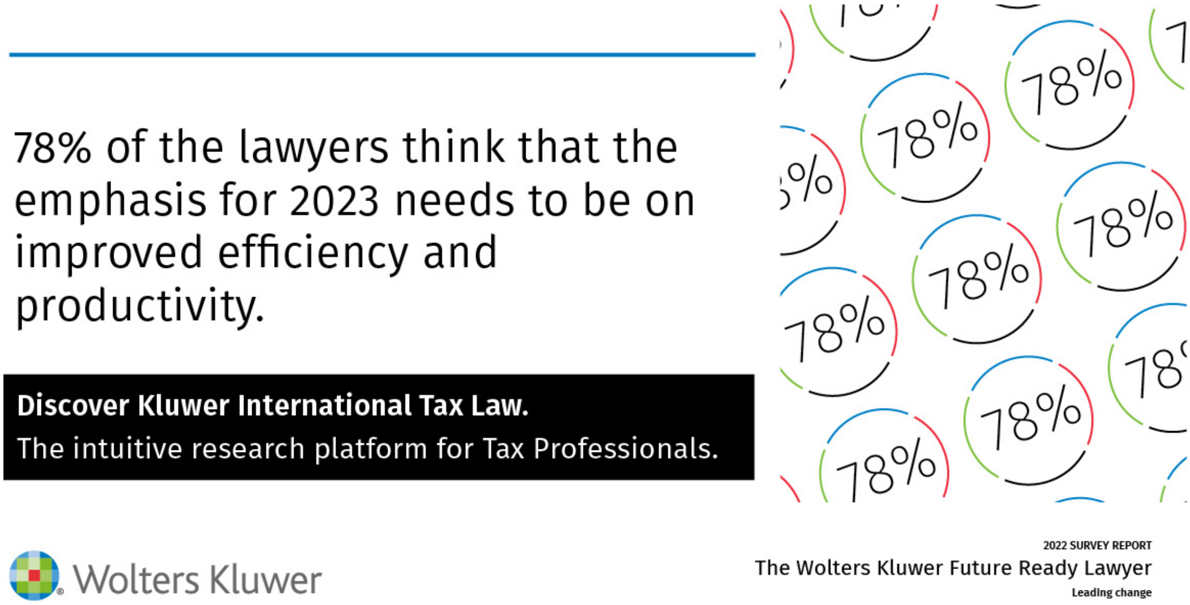

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