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The Changing Paradigm of International Tax Dispute Settlement: What Are the Promises and Challenges of Mandatory Arbitration for China?

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ABSTRACT

International taxation is undergoing considerable legal and policy transformations, which will have deep normative ramifications in business and legal practices worldwide. In particular, international tax disputes will increase in the short term as a consequence of the Base Erosion and Profit Shifting (BEPS) implementation, which is considerably modifying tax regulation in virtually all jurisdictions. BEPS also aims to resolve tax-related disputes more effectively as expressed by the so-called Action 14, which will generate further challenges for many governments. Traditionally, Mutual Agreement Procedure (MAP) has been the main dispute resolution method in the taxation area, and China insists on continuing to use MAP in its bilateral tax treaties. However, with the Organisation for Economic Co-operation and Development (OECD) Model Convention and United Nations Model Convention, there is a trend to incorporate mandatory arbitration as a complementary part of MAP in resolving tax-related disputes. While developed countries mainly support mandatory arbitration, developing states, like China, are reluctant to lose their national sovereignty in the taxation area. Through comparing dispute resolution methods under bilateral investment treaties (BITs) and bilateral tax treaties, this Article critically discusses the advantages of incorporating mandatory arbitration in bilateral tax treaties and demonstrates that national sovereignty will not be decreased by it. As a result, the Article argues that it would, in fact, be beneficial for China to adopt the mandatory arbitration method, which would further strengthen the global reform initiated by the OECD.

INTRODUCTION

Foreign investment is an important resource for the development of the People's Republic of China (PRC or "China"), and China is trying to attract as much foreign investment as possible. For example, there are a growing number of special economic zones (SEZs) established along the coast and in the inner places of mainland China.¹

¹ Koel Roy Choudhury, *Special Economic Zones in China*, 7 SIES J. MGMT. 114, 114 (2010).

In SEZs,² the negative list³ is regulated, and it can provide greater certainty for the foreign investors.⁴ The negative list specifies what projects are prohibited from receiving foreign investment funds.⁵ In comparison, the positive list specifies what projects may receive foreign investment.⁶ National Treatment (NT) prohibits discrimination and requires that “a WTO member may not discriminate on the basis of the national origin of the product.”⁷ In addition, the pre-establishment NT is also provided in the SEZs.⁸ In the past, foreign investors could only enjoy the NT after they founded their firms in mainland China.⁹ However, based on the pre-establishment NT, foreign

² SEZs are defined as “geographically delimited areas, frequently physically secured, that are usually, but not always, outside the customs territory of the host country.” Stephen Creskoff & Peter Walkenhorst, *Implications of WTO Disciplines for Special Economic Zones in Developing Countries* 7 (World Bank, Working Paper No. 4892, 2009), <https://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-4892>. The aim of SEZs is to attract foreign investment through different policy tools. CONNIE CARTER & ANDREW HARDING, *SPECIAL ECONOMIC ZONES IN ASIAN MARKET ECONOMIES* 3 (2010). See also Julien Chaisse & Xueliang Ji, *The Pervasive Problem of Special Economic Zones for International Economic Law—Tax, Investment, and Trade Issues*, 20 *WORLD TRADE REV.* (forthcoming 2020, on file with author).

³ *China Simplifies “Negative List” in Further Easing of Foreign Investment Restrictions*, JONES DAY (Aug. 2018), <https://www.jonesday.com/en/insights/2018/08/china-simplifies-negative-list-in-further-easing-o> (“The Negative List is a list of industries for which foreign investment is either prohibited, or subject to greater scrutiny and restrictions.”).

⁴ Qinhua Wang, *The Management of Foreign Private Equity Funds Involves Foreign Investment and Foreign Exchange in the China (Shanghai) Pilot Free Trade Zone*, 50 *CHINESE ECON.* 249, 256 (2017).

⁵ Gladie Lui, *Shanghai Pilot Free Trade Zone: Shaping of China’s Future Foreign Investment Environment*, 40 *INT’L TAX J.*, July-Aug. 2014, at 31, 32.

⁶ “Positive-List” Approach Popular at WTOI Investment Talks, *INT’L CTR. FOR TRADE & SUSTAINABLE DEV.* (2002), <http://www.ictsd.org/bridges-news/bridges/news/positive-list-approach-popular-at-wtoi-investment-talks>.

⁷ Peter M. Gerhart & Michael S. Baron, *Understanding National Treatment: The Participatory Vision of the WTO*, 14 *IND. INT’L & COMP. L. REV.* 505, 505 (2004). In fact, NT is a fundamental principle of the WTO to the extent that very few exceptions may apply to it. See generally Julien Chaisse, *Exploring the Confines of International Investment and Domestic Health Protections—Is a General Exceptions Clause a Forced Perspective?* 39 *AM. J.L. & MED.* 332, 361 (2013).

⁸ See generally Qianwen Zhang, *Opening Pre-Establishment National Treatment in International Investment Agreements: An Emerging “New Normal” in China?*, 11 *ASIAN J. WTO & INT’L HEALTH L. & POL’Y* 437 (2016).

⁹ Delei Peng & Xiuyan Fei, *China’s Free Trade Zones: Regulatory Innovation, Legal Assessment and Economic Implication*, 50 *CHINESE ECON.* 238, 239 (2017).

investors enjoy equal favorable rights compared to the local investors in admittance to the local market.¹⁰ Meanwhile, in SEZs, foreign investors enjoy more preferential treatment compared to local firms, and the more preferential treatment is fine under the NT.¹¹ All these measures are aimed at attracting more foreign investment.

Among the measures at China's disposal, taxation is a great tool to attract foreign direct investment. Taxation, much like GDP, is very significant for China. Based on the PRC Ministry of Finance's 2016 taxation report, tax revenue¹² is around CNY (Chinese Yuan) 16 trillion while the income of taxation is about CNY 13 trillion.¹³ In developed states, such as the United States, tax revenue mainly comes from personal income tax.¹⁴ In contrast to developed states, developing states like China are focusing more on taxing corporations and enterprises.¹⁵ In 2016, the Organisation for Economic Co-operation and Development (OECD) pointed out that weak investment has contributed to low productivity growth.¹⁶ The report illustrates that annual global foreign direct investment (FDI) was down over 18% in non-OECD countries, including China, while there was a rise of 6% in OECD countries.¹⁷ This disparity partly exists because OECD countries have initiated a lot of measures to provide a predictable,

¹⁰ RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 198 (Oxford University Press, 2012). See generally Julien Chaisse & Mitsuo Matsushita, *China's 'Belt and Road' Initiative: Mapping the World Trade Normative and Strategic Implications*, 52 J. WORLD TRADE 163, 169 (2018).

¹¹ See Wanda Tseng & Harm Zebregs, *Foreign Direct Investment in China: Some Lessons for Other Countries*, INT'L MONETARY FUND (Feb. 2002), <https://www.imf.org/external/pubs/ft/pdp/2002/pdp03.pdf>.

¹² Ministry of Finance of the People's Republic of China, *Fiscal Revenue and Expenditure Situation in 2016* (2017), http://gks.mof.gov.cn/zhengfuxinxi/tongjishuju/201701/t20170123_2526014.html (Chinese report unavailable in English language, on file with author).

¹³ *Id.*

¹⁴ Richard M. Bird & Eric M. Zolt, *Redistribution Via Taxation: The Limited Role of the Personal Income Tax in Developing Countries*, 52 UCLA L. REV. 1627, 1633 (2004).

¹⁵ *Id.*

¹⁶ Yvan Guillemette, *The Contribution of Weak Investment to the Productivity Slowdown*, OECD ECOSCOPE (June 10, 2016), <https://oecdecoscope.blog/2016/06/10/the-contribution-of-weak-investment-to-the-productivity-slowdown/>.

¹⁷ *FDI in Figures*, OECD (2017), <http://www.oecd.org/daf/inv/investment-policy/FDI-in-Figures-April-2017.pdf>. See generally Michael J. Enright, *China's Inward Investment: Approach and Impact*, in *CHINA'S INTERNATIONAL INVESTMENT STRATEGY: BILATERAL, REGIONAL, AND GLOBAL LAW AND POLICY* 28 (Julien Chaisse ed., 2019).

stable investment environment to attract FDI, including the mandatory arbitration mechanism for resolving tax-related disputes.¹⁸

Even though the MAP process is the main dispute resolution method used for tax-related disputes in bilateral tax treaties, it resulted in inefficiency problems in many countries, including BRICS (Brazil, Russia, India, China, and South Africa).¹⁹ On October 5, 2015, the OECD released its final report on improving the effectiveness of dispute resolution mechanisms (Action 14) under its Action Plan on Base Erosion and Profit Shifting (BEPS).²⁰ Fifteen BEPS actions were released in this report.²¹ Action 14 also represents a commitment by countries to implement the “minimum standard” on dispute resolution.²² This report states that the G20 and OECD countries participating in the BEPS project have agreed to implement three overarching principles that represent a minimum standard, with respect to the MAP process, by incorporating these principles into domestic law and/or their treaty interpretation and application.²³ The “minimum standard” principles include the following:

1. Allowing taxpayers access to the MAP process when they meet the requirements;
2. Verifying that domestic administrative procedures do not block access to the MAP process; and
3. Having countries implement Article 25 of the OECD Model Tax Convention in good faith.²⁴

¹⁸ *Id.* See also Julien Chaisse & Christian Bellak, *Do Bilateral Investment Treaties Promote Foreign Direct Investment? Preliminary Reflections on New Methodology*, 3 TRANSNAT'L CORP. REV. 3, 4 (2011); Julien Chaisse & Christian Bellak, *Navigating the Expanding Universe of Investment Treaties—Creation and Use of Critical Index*, 18 J. INT'L ECON. L. 79, 83 (2015).

¹⁹ See generally ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), MODEL TAX CONVENTION ON INCOME AND ON CAPITAL, Art. 25 (2014) [hereinafter OECD MODEL 2014]. See also Julien Chaisse, *Investor-State Arbitration in International Tax Dispute Resolution: A Cut Above Dedicated Tax Dispute Resolution?*, 35 VA. TAX REV. 149, 160 (2016) [hereinafter Chaisse, *Investor-State*].

²⁰ *Action 14 Mutual Agreement Procedure*, OECD, <http://www.oecd.org/tax/beps/beps-actions/action14/> (last updated in 2019) [hereinafter *Action 14 Procedure*].

²¹ ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), MAKING DISPUTE MECHANISMS MORE EFFECTIVE, ACTION 14: 2015 FINAL REPORT 3 (2015) [hereinafter OECD ACTION 14: 2015 FINAL REPORT].

²² *Action 14 Procedure*, *supra* note 20.

²³ OECD ACTION 14: 2015 FINAL REPORT, *supra* note 21, at 11.

²⁴ *Id.* at 12.

BRICS considered the need to improve the efficiency of MAP and reached an agreement to resolve this problem.²⁵ However, the Article 14 Report did not mention what measures the countries need to implement to achieve this goal.

BEPS raises challenges for many countries with regard to settling international tax disputes. The objective of this Article is not to review the ongoing discussion and potential reform of the methods to resolve international tax disputes at the global level. Instead, this Article focuses on China's position and, more specifically, the pros and cons associated with China adopting a mechanism of mandatory tax arbitration in the near future. This Article proposes that China is ready to embrace a more sophisticated mechanism for tax dispute resolution that involves a mixed system of mandatory arbitration. To demonstrate this thesis, this Article deploys analysis on five levels (and in five parts) that complement one another. Part I states the common methods in resolving tax-related disputes. Part II deals with the most significant concern for states when incorporating mandatory arbitration in bilateral tax treaties. Next, Part III analyzes the reasons why taxpayers prefer mandatory arbitration in resolving tax-related disputes. Part IV emphasizes other benefits of the tax-related mandatory arbitration. Finally, Part V recognizes the benefits of China adopting the tax-related mandatory arbitration method.

I

METHODS IN RESOLVING TAX-RELATED DISPUTES

Based on the BEPS actions issued by the OECD, there are a number of changes to the current international taxation system, and each state has to adopt some measures related to their national taxation systems. In the long term, one goal of BEPS is to decrease tax-related disputes. In the short term, disputes will be more likely to arise when incorporating the new standards in tax matters.²⁶ Consequently, it is essential to focus on the methods taxpayers always depend on when

²⁵ MEMORANDUM OF COOPERATION, <https://lawprofessors.typepad.com/files/brics-mou-for-crs.pdf> (last visited October 23, 2019).

²⁶ See *Public Discussion Draft BEPS Action 14: Making Dispute Resolution Mechanisms More Effective*, OECD 4, 18, 27 (2015), <https://www.oecd.org/ctp/dispute/discussion-draft-action-14-make-dispute-resolution-mechanisms-more-effective.pdf> [hereinafter *Public Discussion Draft BEPS Action 14*]. See generally Julien Chaisse & Xueliang Ji, "Soft Law" in *International Law-Making: How Soft International Taxation Law is Reshaping International Economic Governance*, 13 *ASIAN J. WTO L. & HEALTH POL'Y* 463 (2018).

faced with tax-related disputes, and they will be discussed in detail in the following parts.

A. Local Remedies

There are several ways to resolve tax-related disputes. Local remedies can be used as a first step. Taxpayers can initiate litigation in the appropriate administrative tribunal. However, foreign taxpayers tend to disfavor this method.²⁷ One reason for this is because they are not familiar with the laws of the host state. For example, foreign taxpayers and the competent authority of the host state may have different interpretations of the same issue and taxation clause.²⁸ Additionally, the court in the host state may be biased to some extent. It is inevitable for the host state to protect itself, especially when the disputes arise because of the host state's policies. If the dispute contains issues related to the host state's national interests, the related court or administrative tribunal is more likely to reject the foreign taxpayers' request.²⁹

Bilateral tax treaties also contain a clause related to local remedies.³⁰ The 2014 OECD Model Convention provides that

[t]he competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention.³¹

In other words, the MAP process can only be initiated when the competent authority cannot decide and resolve the disputes unilaterally. The related competent authority's unilateral resolution can be treated as a type of local remedy.

B. Arbitration in Bilateral Investment Treaties (BITs)

Aside from local remedies, mandatory arbitration in BITs can also be functional. Taxpayers tend to make claims through investment law

²⁷ See generally MICHAEL LANG & JEFFREY OWENS, INTERNATIONAL ARBITRATION IN TAX MATTERS (2016).

²⁸ MICHAEL LANG & MARIO ZÜGER, SETTLEMENT OF DISPUTES IN TAX TREATY LAW 15 (2002).

²⁹ See generally LANG & OWENS, *supra* note 27, at 982.

³⁰ OECD MODEL 2014, *supra* note 19, at 38–39.

³¹ *Id.*

treaties rather than international tax treaties.³² Compared with the MAP dispute resolution mechanism usually in bilateral tax treaties, mandatory arbitration within the BITs provides a great advantage.³³ The advantage is that investors can determine when there has been a breach of a treaty obligation and pursue a claim.³⁴ That is to say, “the investor may take action . . . to defend his or her rights accruing from the BIT because it is a claim of the investor himself or herself but not of the contracting state.”³⁵

With respect to the tax-related dispute resolution methods in bilateral tax treaties, the related competent authorities control the determining power.³⁶ Without confirmation from the related competent authorities, the MAP process cannot be initiated.³⁷ According to Article 25(5) of the OECD Model Convention, the taxpayer/investor can only bring tax disputes to arbitration if they cannot be resolved through the MAP process.³⁸ The arbitration clause in international investment law, however, allows foreign investors to claim their entire dispute to international arbitral tribunals directly.³⁹ For instance, even if the national court has already ruled against an investor, the investor can still make a claim to an international arbitration tribunal related to the same issue.⁴⁰ One such award took place in *Deutsche Bank v. Sri Lanka*.⁴¹ In that case, the claimant could not get a fair hearing in the Supreme Court of Sri Lanka and brought the claim to the international

³² See generally *Duke Energy Electroquil Partners v. Republic of Ecuador*, ICSID Case No. ARB/04/19 (2008) (gives one example where the claim was made through the United States-Ecuador Bilateral Investment Treaty regarding import tax and custom duties).

³³ Julien Chaisse, *Making Tax Dispute Resolution Mechanisms More Effective—The Base Erosion and Profit Shifting Project and Beyond*, 10 CONTEMP. ASIA ARB. J. 1, 21 (2017) [hereinafter Chaisse, *BEPS*].

³⁴ See generally Maira de Melo Vieira, *The Regulation of Tax Matters in Bilateral Investment Treaties: A Dispute Resolution Perspective*, 8 DISP. RESOL. INT’L 63 (2014).

³⁵ Chaisse, *BEPS*, *supra* note 33, at 26 (quoting Treaty Between the United States of America and Mongolia Concerning the Encouragement and Reciprocal Protection of Investment, U.S.-Mong., Oct. 6, 1994).

³⁶ Michael J. McIntyre, *Comments on the OECD Proposal for Secret and Mandatory Arbitration of International Tax Disputes*, 7 FLA. TAX REV. 622, 623–24 (2006).

³⁷ OECD MODEL 2014, *supra* note 19.

³⁸ *Id.*

³⁹ Chaisse, *BEPS*, *supra* note 33, at 25.

⁴⁰ *Id.* at 26.

⁴¹ See *Deutsche Bank AG v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/09/02, Award, (Oct. 31, 2012).

tribunal, which held that Sri Lanka had breached the Fair and Equitable Treatment (FET) principle.⁴²

The MAP process offers a chance for taxpayers to escape a potentially unfair hearing by putting the case in front of an international and independent arbitration tribunal. By creating a separate treaty-based set of rules to govern host-state conduct, the taxpayer does not expose himself to the uncertainties of host-state laws, regulations, and policies.⁴³ The MAP process gives taxpayers an alternative to the host-state judicial system when they seek remedies from host-state actions. Foreign taxpayers can choose freely from the domestic remedies and the international arbitration method.⁴⁴ However, if a tax-related dispute arises, the local administrative tribunal's consideration is essential under the OECD Model Convention.⁴⁵ If the related administrative body or the local court has resolved the dispute, regardless of whether the taxpayers are satisfied, international arbitration cannot help the taxpayers. This is especially so in cases regarding the competent authorities of developing countries for MAP. Because the competent authorities lack experience or are often not independent, taxpayers seek international arbitration to get a fair hearing and award.⁴⁶ Accordingly, international arbitration, used in accordance with the BITs, may provide a substantial advantage for the taxpayer.⁴⁷

Additionally, foreign investors are more likely to bring their claims based on the BITs rather than international tax treaties because of the protection the substantive clause provides.⁴⁸ The substantive clauses within the international investment treaties and the international tax

⁴² *Id.* at 108.

⁴³ Michele Potestà, *Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept*, 28 ICSID REV. 88, 88–122 (2013).

⁴⁴ Chaisse, *BEPS*, *supra* note 33, at 165.

⁴⁵ OECD MODEL 2014, *supra* note 19.

⁴⁶ *See generally* Carlos Protto, *Mutual Agreement Procedures in Tax Treaties: Problems and Needs in Developing Countries and Countries in Transition*, 42 INTERTAX 176 (2014).

⁴⁷ *See* U.N. Conference on Trade and Development, *World Investment Report*, 124, (2015).

⁴⁸ *See* Katia Yannaca-Small, *Interpretation of the Umbrella Clause in Investment Agreements*, in INTERNATIONAL INVESTMENT LAW: UNDERSTANDING CONCEPTS AND TRACKING INNOVATIONS 101 (OECD, 2008). *See generally* Julien Chaisse, *The Treaty Shopping Practice: Corporate Structuring and Restructuring to Gain Access to Investment Treaties and Arbitration*, 11 HASTINGS BUS. L. REV. 225 (2015).

treaties are different, but they share the feature of nondiscrimination.⁴⁹ The differences between the two exist because the international tax treaties and international investment treaties do not have the same purpose. The principles of international investment law are National Treatment (NT), Most Favored Nations (MFN), Fair and Equitable Treatment (FET), Full Protection and Security (FPS), and Umbrella Clause.⁵⁰ The main purposes of international tax treaties are (1) to prevent double taxation and double nontaxation, and (2) to properly allocate the financial revenue.⁵¹ On the other hand, the purpose of international investment treaties, particularly BITs, is to protect the investments that produce those revenues.⁵² Therefore, the scope of taxpayer protection offered by the international investment tax regime is larger in comparison to that provided by the bilateral tax treaties.⁵³ International tax treaties offer, to some extent, limited protections to taxpayers.

At the same time, taxpayers often use the FET standard to protect their profits when faced with tax-related disputes under the BITs. This is because arbitral tribunals tends to expand the scope of this standard.⁵⁴ For instance, the *Roussalis v. Romania* award expanded the scope of the FET standard and stated that it is not precisely defined beyond general principles.⁵⁵ In the *Occidental Exploration v. Ecuador* case, the tribunal explained the FET standard aims to provide a stable and predictable environment for foreign investors.⁵⁶ Investors will make their investment plans based on their expectations.⁵⁷ Because the tax regulations issued by the host government destroyed this predictability,

⁴⁹ JULIEN CHAISSE, THE E15 INITIATIVE, INTERNATIONAL INVESTMENT LAW AND TAXATION: FROM COEXISTENCE TO COOPERATION 11 (2016) [hereinafter CHAISSE & THE E15].

⁵⁰ See DOLZER & SCHREUER, *supra* note 10, at 161. See generally Julien Chaisse, *Promises and Pitfalls of the European Union Policy on Foreign Investment—How Will the New EU Competence on FDI Affect the Emerging Global Regime?*, 15 J. INT'L ECON. L. 51 (2012).

⁵¹ See Ariane Pickering, *Why Negotiate Tax Treaties*, U.N. DEP'T ECON. & SOC. AFF., May 2013, at 3–4.

⁵² CHAISSE & THE E15, *supra* note 49, at 12.

⁵³ *Id.*

⁵⁴ See *id.* at 11.

⁵⁵ See Spyridon Roussalis v. Romania, ICSID Case No. ARB/06/1, Award, ¶ 318 (Dec. 1, 2011).

⁵⁶ Occidental Exploration and Production Co. v. The Republic of Ecuador, Case No. UN 3467, Final Award, 62–63 (London Ct. of Int'l Arb. 2004).

⁵⁷ *Id.* at 62.

the related tax regulations have breached the FET standard.⁵⁸ For instance, as long as foreign investors are treated worse in the taxation area, they will file their claims against the host government based on this standard. However, it should be noted that this criterion does not require equity because the FET standard is an absolute standard.⁵⁹ That means it is acceptable for the foreign investors to be treated more favorably than local individuals and companies. Furthermore, based on section 25(3) of the 2014 OECD Model Convention, mandatory arbitration can only be initiated once the final taxation is imposed.⁶⁰ Additionally, “[t]he competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention.”⁶¹ However, no matter whether the taxation is actually imposed, foreign investors can still proceed with arbitration as long as they find the taxation is a breach of their rights under the BITs.⁶² Yet the terms of many bilateral tax treaties and double tax treaties do not incorporate mandatory arbitration as a dispute resolution method.⁶³ The MAP process is still an essential part of the process before taxpayers can reach mandatory arbitration even if the bilateral tax treaties contain a mandatory arbitration clause. For example, in the United States-Canada bilateral tax treaty, taxpayers cannot directly reach the mandatory arbitration clause.⁶⁴ And what is worse, no matter the unilateral dispute resolution process used by the related competent authority or in the MAP process, lack of transparency means the related state will have more power to control the whole process without protecting the foreign taxpayers’ interests.⁶⁵

In addition, under the international investment treaties and BITs, arbitral awards are enforced in accordance with the corresponding rules

⁵⁸ *Id.* at 64.

⁵⁹ See DOLZER & SCHREUER, *supra* note 10, at 133.

⁶⁰ See OECD MODEL 2014, *supra* note 19.

⁶¹ *Id.*

⁶² See CHAISSE & THE E15, *supra* note 49.

⁶³ See generally Ehab Farah, *Mandatory Arbitration of International Tax Disputes: A Solution in Search of a Problem*, 9 FLA. TAX REV. 703 (2009).

⁶⁴ See Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, Can.-U.S., Sept. 26, 1980, IRS Treaty, <https://www.irs.gov/pub/irs-trty/canada.pdf> [hereinafter Can.-U.S. Tax Convention].

⁶⁵ See generally Michael Lennard, *International Tax Arbitration in Developing Countries*, in INTERNATIONAL ARBITRATION IN TAX MATTERS 1060–62 (2016).

of the chosen arbitral institution so that the award is easier to enforce.⁶⁶ For instance, the International Convention on the Settlement of Investment Disputes between States and Nationals of Other States⁶⁷ and the respective BITs are responsible for enforcing the arbitral awards determined by the International Center for Settlement of Investment Disputes (ICSID).⁶⁸ The Arbitration Rules and the respective BITs govern the enforcement of the awards as determined by the United Nations Commission on International Trade Law (UNCITRAL).⁶⁹ Article 54 of the ICSID emphasizes that “[e]ach Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State.”⁷⁰ This means that states must enforce the arbitral awards. Besides, the awards initiated by the arbitral tribunal in the bilateral tax treaties only bind the two competent authorities.⁷¹ The awards reached by the arbitral tribunal in BITs do not only bind the contracting parties but also bind the signatories of ICSID’s Convention on the Settlement of Investment Disputes between States and Nationals of Other States.⁷² Furthermore, because ICSID is an agency of the World Bank, the member states of the World Bank will voluntarily enforce ICSID awards.⁷³ Therefore, to avoid adverse consequences, such as sanctions, from noncompliance with ICSID awards, most of the losing states comply with the final awards, which leads to a very robust and trusted dispute mechanism.⁷⁴ Although taxpayers should file their claims based on the bilateral tax treaties, a phenomenon exists in which a great number of states do not incorporate a mandatory arbitration

⁶⁶ Vincent O. Orlu Nmehielle, *Enforcing Arbitration Awards Under the International Convention for the Settlement of Investment Disputes (ICSID Convention)*, 7 ANN. SURV. INT’L & COMP. L. 21, 30, 36 (2001).

⁶⁷ See INT’L. CTR. FOR SETTLEMENT OF INV. DISPUTES, ICSID CONVENTION, REGULATIONS AND RULES (2006), <https://icsid.worldbank.org/en/Documents/icsiddocs/ICSID%20Convention%20English.pdf>.

⁶⁸ CHAISSE & THE E15, *supra* note 49.

⁶⁹ Chaisse, *BEPS*, *supra* note 33, at 27.

⁷⁰ Dany Khayat, *Enforcement of Awards in ICSID Arbitration*, MAYER BROWN (Dec. 19, 2011), <https://www.mayerbrown.com/en/perspectives-events/publications/2011/12/enforcement-of-awards-in-icsid-arbitration>.

⁷¹ *See id.*

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *See id.*

clause in their bilateral tax treaties. China is one of these states.⁷⁵ In this respect, foreign investors tend to increasingly use the arbitration clause under BITs to resolve their taxation disputes at the international level.

Because states are worried about their own national sovereignty, they tend to narrow the scope of taxation disputes to arbitration under BITs.⁷⁶ As discussed above, many states are limiting the scope of the FET standard.⁷⁷ The *Nations Energy Corp. v. Republic of Panama* case, for instance, interprets the BIT at issue to exclude claims stemming from taxation matters based on the FET standard.⁷⁸ Additionally, if there are no explicit words mentioning or interpreting the FET standard in a BIT, the tax measures are excluded from consideration in the treaty. If the FET standard is not explicitly set out in the treaties, it cannot be applied to the tax measures.⁷⁹ Moreover, there is a growing trend that contracting parties tend to limit—or even exclude—the tax measures from the BIT.⁸⁰ For instance, the 2015 Indian Model BIT-EU excludes taxation from the scope of the treaty.⁸¹ Another example is the agreement between the governments of Hong Kong and New Zealand to promote and protect investments.⁸² The Hong Kong-New Zealand agreement states that it “shall not apply to matters of taxation in the area of either Contracting Party.”⁸³ Instead, “[s]uch matters shall be governed by the domestic laws of each Contracting Party and the terms of any agreement relating to taxation concluded between the Contracting Parties.”⁸⁴

⁷⁵ See generally Org. for Econ. Co-op. and Dev., *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS* (last updated Oct. 18, 2019), <http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm> (follow “Signatories and Parties (MLI Positions)” hyperlink) [hereinafter MLI Positions] (China signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting but has not entered it into force).

⁷⁶ See CHAISSE & THE E15, *supra* note 49, at 9.

⁷⁷ See, e.g., *Nations Energy Corp. v. Republic of Panama*, ICSID Case No. ARB/06/19, Award, ¶ 39 (Nov. 24, 2010).

⁷⁸ See *id.*

⁷⁹ Chaisse, *Investor-State*, *supra* note 19, at 160.

⁸⁰ Model Text for the Indian Bilateral Investment Treaty, Dec. 28, 2015, Article 2.6 (iv).

⁸¹ *Id.*

⁸² Agreement for the Promotion and Protection of Investments, H.K.-N.Z., Art. 8(2), July 6, 1995, Trade and Industry Dep’t, Gov’t of H.K.

⁸³ *Id.*

⁸⁴ *Id.*

Meanwhile, states without mandatory arbitration in their BITs retain sovereignty by making new policies related to public interests, such as those related to the protection of public health and the environment. These states also escape the independent tribunal's intervention and the possibility of an award to the person bringing the action.⁸⁵ Although these states' policies may sometimes decrease foreign investors' interest, the mandatory arbitration under BITs cannot resolve these types of tax-related disputes.⁸⁶

The most common clause referring to tax-related disputes in BITs is the expropriation provision.⁸⁷ Expropriation means to seize private property for a public purpose.⁸⁸ There are two kinds of expropriation: direct and indirect.⁸⁹ To tell the two apart, one can focus on the actual effect of the expropriation clause.⁹⁰ Taxation measures are typically used as an indirect expropriation method and, in situations where tax-related disputes arise, they can be resolved by the mandatory arbitration under BITs.⁹¹ For example, the case *Link-Trading v. Moldova* refers to the type of dispute mentioned above.⁹² In this case, the claimant protested that the defendant issued changes to the custom tax treatment, which violated governmental guarantees of tax stability. The claimant in this case claimed these tax changes substantially deprived the claimant of its business and constituted measures equivalent to expropriation.⁹³ The claimant resorted to the mandatory arbitration in the United States-Moldova BIT.⁹⁴ Another example of a taxpayer being deprived of business because of aggressive tax changes can be found in the case *Tza Yap Shum v. Peru* and in the accompanying award.⁹⁵ There is a remarkable consensus that taxation and tax measure

⁸⁵ See generally Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1576 (2000).

⁸⁶ See generally LANG & OWENS, *supra* note 27.

⁸⁷ Jasmin Kollmann & Laura Turcan, *Overview of the Existing Mechanisms to Resolve Disputes and Their Challenges*, in INTERNATIONAL ARBITRATION IN TAX MATTERS 166–67 (2016).

⁸⁸ William H. Reeves, *Expropriation, Confiscation, Nationalization—What One Can Do About Them*, 24 BUS. LAW. 867, 867 (1969).

⁸⁹ DOLZER & SCHREUER, *supra* note 10, at 101.

⁹⁰ *Id.*

⁹¹ See *Link-Trading Stock Co. v. Dep't for Customs Control of the Republic of Moldova*, Final Award, ITA Inv. Treaty Cases (2002).

⁹² See *id.*

⁹³ *Id.* at 10.

⁹⁴ *Id.* at 4.

⁹⁵ See generally *Tza Yap Shum v. Republic of Peru*, ICSID Case No. ARB/07/6, Award, (July 7, 2011).

enforcement can become expropriatory if the measures are “confiscatory, arbitrary, abusive, or discriminatory.”⁹⁶ However, the expropriation clause has limitations. Based on case law, changes in taxation policies do not always trigger the expropriation clause.⁹⁷ Although sudden changes may lead to some disputes, these taxation changes are not treated as expropriation if the taxpayers do not lose possession of real property.⁹⁸

Even though foreign investors can win these types of cases in the end, it is difficult for them to proceed with the arbitration award all by themselves. If the losing party refuses to uphold the award, foreign investors can ask the states who signed the so-called New York Convention for help and then seize the losing party’s assets in their jurisdictions.⁹⁹ These arbitration proceedings under BITs can be time- and money-consuming. As a result, foreign investors must waive certain substantial rights and profits to get the award.¹⁰⁰ Accordingly, arbitration under BITs is an imperfect way to protect the taxpayers.

Contracting states dislike mandatory arbitration in BITs because of its regulatory chilling effect.¹⁰¹ The regulatory chilling effect occurs because the high costs of investor-state arbitration can lead states to be reluctant to enact measures that could be a breach of their obligations.¹⁰² Inconsistent arbitration decisions that adopt “surprising investment obligation interpretations” exacerbate the chilling effect.¹⁰³ Therefore, as long as there is a possibility that measures can be a breach of BITs, the states are unlikely to initiate the measures—even in cases of public interest. However, this chilling effect is less critical in bilateral tax treaties. First, in tax-related areas, states are free to construct and implement the measures regardless of the mandatory arbitration clause in bilateral tax treaties. States are freer because the arbitration clause may not come into the play.¹⁰⁴ Second, mandatory arbitration clauses’ involvement in bilateral tax treaties can be a

⁹⁶ *Id.* ¶ 181.

⁹⁷ *Id.*

⁹⁸ Chaisse, *Investor-State*, *supra* note 19, at 152.

⁹⁹ Kollmann & Turcan, *supra* note 87, at 168.

¹⁰⁰ *See generally* LANG & OWENS, *supra* note 27.

¹⁰¹ *See generally* Now Try Collecting, *ECONOMIST*, (Aug. 2, 2014), <https://www.economist.com/business/2014/08/02/now-try-collecting>.

¹⁰² Chaisse, *BEPS*, *supra* note 33, at 43.

¹⁰³ *Id.*

¹⁰⁴ OECD Model 2014, *supra* note 19.

measure to prevent states from implementing measures that might be a breach of their obligations.¹⁰⁵

C. Dispute Resolution Methods in Bilateral Tax Treaties

Although mandatory arbitration in BITs can be reached to resolve tax-related disputes, the arbitral tribunal that mainly deals with investment issues may not be the ideal professional body to resolve those disputes. In these situations, the dispute resolution methods in the bilateral tax treaties between contracting states may be more appropriate for the parties. To resolve tax-related disputes, there are two steps for nonmandatory arbitration tax treaties and three steps for mandatory arbitration tax treaties. The first step is for the related competent authority to resolve the dispute unilaterally. The taxpayers choose a competent authority by submitting their dispute to said authority.¹⁰⁶ If the competent authority cannot resolve the dispute in its entirety, then the second step is for the taxpayers to submit a request to initiate the MAP process.¹⁰⁷ If the parties cannot resolve the dispute through the MAP process, the parties must follow the mandatory arbitration clause.

The MAP process is controlled by the competent authorities, and taxpayers have little legal standing during the process. What taxpayers can do is provide some basic information and evidence related to the disputes in written materials.¹⁰⁸ According to the 2017 OECD Model Convention, taxpayers submit their disputes to the relevant competent authority which attempts to unilaterally resolve the disputes before the MAP process.¹⁰⁹ If the competent authority resolves the dispute unilaterally, the MAP process will not commence. The competent authority has full discretion to reject the submission of the disputes.¹¹⁰ The major shortcoming of the competent authority's entire decision-

¹⁰⁵ See *Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, OECD (2016), <https://www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf>.

¹⁰⁶ ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), MODEL TAX CONVENTION ON INCOME AND ON CAPITAL: CONDENSED VERSION 2017, 44 (2017) [hereinafter OECD MODEL CONDENSED 2017].

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* at 453.

¹⁰⁹ See *id.* at 44–45.

¹¹⁰ Kollmann & Turcan, *supra* note 87, at 155.

making process is the lack of transparency.¹¹¹ This shortcoming is further highlighted when sensitive issues, like national interests, are involved in the disputes. The related state can control the process to some extent; in this regard, the state benefits from protecting its national sovereignty.

Two kinds of tax-related arbitration exist: voluntary and mandatory. Some scholars, however, argue that all arbitration is voluntary in nature.¹¹² They make this argument because the arbitration is based on a contract dispute between parties, and the disputing parties agreed to all aspects of the contract—including the arbitration clause.¹¹³ While the classification here is about the initiative method, voluntary arbitration can only be initiated when the competent authorities and taxpayers agree to said arbitration.¹¹⁴ Thus, the taxpayers cannot directly submit the disputes for arbitration. As a result, voluntary arbitration offers weak protection for taxpayers. The U.N. Model Convention requires that both competent authorities agree in order to initiate arbitration.¹¹⁵ If national interests are involved in the dispute, the competent authorities are less likely to support arbitration. In stark contrast, taxpayers can initiate mandatory arbitration without the competent authority's confirmation as long as certain conditions are met.¹¹⁶ Thus, taxpayers are better equipped to protect themselves with mandatory rather than voluntary arbitration.

The OECD initiated Base Erosion and Profit Shifting (BEPS), which is related to mandatory arbitration, especially the fourteenth movement and the 2008 OECD Model Convention.¹¹⁷ Although BEPS is merely a suggestion for states, this dispute resolution method has been incorporated into some bilateral tax treaties, especially those of

¹¹¹ Jean-Pierre Lieb, *Introduction: Taking the Debate Forward*, in INTERNATIONAL ARBITRATION IN TAX MATTERS 61 (2016).

¹¹² See generally Gus Van Harten & Martin Loughlin, *Investment Treaty Arbitration as a Species of Global Administrative Law*, 17 EUR. J. INT'L L. 121, 121–50 (2006).

¹¹³ See *What Is an Arbitration Agreement?*, FREEADVICE LEGAL (2019), https://law.freeadvice.com/litigation/arbitration/agreement_arbitration.htm.

¹¹⁴ Kollmann & Turcan, *supra* note 87, at 116.

¹¹⁵ See UNITED NATIONS, DEP'T OF ECON. & SOC. AFFAIRS, MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES 31 (2011) [hereinafter U.N. 2011].

¹¹⁶ See OECD MODEL CONDENSED 2017, *supra* note 106.

¹¹⁷ See generally ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), MODEL TAX CONVENTION ON INCOME AND ON CAPITAL: CONDENSED VERSION 2008 (2008) [hereinafter OECD MODEL CONDENSED 2008].

developed states. Despite being clearly regulated in the Model Convention, BEPS provides flexibility for states to incorporate dispute resolution. For example, the United States-Germany double tax treaty includes mandatory arbitration.¹¹⁸ But the United States and Germany included some restrictions on mandatory arbitration. According to the treaty, if the competent authorities cannot resolve a dispute, the dispute may be submitted for arbitration so long as the competent authorities agree to this dispute resolution method.¹¹⁹

For example, in the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI), China disallows mandatory arbitration in tax matters.¹²⁰ Developing countries, like China and India, are more likely to use the MAP process to resolve tax-related disputes. The MAP process is a kind of diplomatic dispute resolution method in which the national interests can be significant.¹²¹ Developing countries have several concerns about tax-related mandatory arbitration.¹²² One concern is that tax-related arbitration is quite professional, which requires many highly skilled workers.¹²³ For example, the competent authorities need highly skilled professional workers and the contracting parties need highly skilled tax lawyers.¹²⁴ Developed states can put a lot of money and resources toward training professional staff, but developing states lack the money and resources to complete the training of their professional staff. Additionally, arbitration fees are expensive. In the arbitration sample of the OECD Model Convention, the competent authority that provides the arbitration meeting venue should bear the cost if the costs are essential.¹²⁵

¹¹⁸ See Protocol Amending the Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Respect to Taxes on Income and Capital and to Certain Other Taxes, Ger.-U.S., June 1, 2006, S. Treaty Doc. No. 109-20.

¹¹⁹ *Id.* at 18.

¹²⁰ See MLI Positions, *supra* note 75 (the website has listed the countries which commit to mandatory arbitration in tax matters while China has signed but not entered into force).

¹²¹ See Kollmann & Turcan, *supra* note 87, at 155.

¹²² Lieb, *supra* note 111, at 68.

¹²³ Lennard, *supra* note 65, at 1047.

¹²⁴ U.N. 2011, *supra* note 115.

¹²⁵ Memorandum of Understanding Between the Competent Authorities of Canada and the United States of America, Can.-U.S., December 2008, Article 13, https://www.irs.gov/pub/irs-utl/2010_arbitration_mou_nov_8-10_-_final.pdf [hereinafter Can.-U.S. Memorandum of Understanding].

Regardless of whether there is mandatory arbitration in BIT or in bilateral tax treaties, the cost of the arbitration is a big problem that the contracting states have to face.¹²⁶ Being a party to an investor-state arbitration is capital intensive.¹²⁷ Even if the state is successful, the costs of joining an arbitration are huge.¹²⁸ State sovereignty is the main concern vis-à-vis arbitration, especially for the governments of developing states, including the Chinese government.¹²⁹

II MANDATORY ARBITRATION WILL NOT DECREASE NATIONAL SOVEREIGNTY

Mandatory arbitration in tax matters will not affect state sovereignty. Instead, mandatory arbitration is the symbol of state sovereignty. When compared to the mandatory arbitration clause in BITs, the arbitration process gives rise to concerns regarding its legitimacy and democratic accountability. One concern is whether there is “lack of knowledge on the part of tribunals regarding non-investment issues related to public policy considerations—like human rights and the environment.”¹³⁰ In investor-state arbitration, investors only pursue their own commercial interests and do not pay enough attention to the public interest of the host state.¹³¹ Conversely, this can be an advantage in tax-related mandatory arbitration.¹³² This occurs because the process is a kind of state-to-state process. For example, in the baseball arbitration method, both competent authorities incorporate national interest considerations into the proposals they submit to the arbitral tribunal.¹³³ In independent arbitration, the competent authorities can reach an agreement on the

¹²⁶ See Lieb, *supra* note 111, at 62.

¹²⁷ Chaisse, *BEPS*, *supra* note 33, at 40.

¹²⁸ *Id.*

¹²⁹ See generally Lieb, *supra* note 111, at 68.

¹³⁰ Chaisse, *BEPS*, *supra* note 33, at 40.

¹³¹ See generally Caroline Henckels, *Balancing Investment Protection and the Public Interest: The Role of the Standard of Review and the Importance of Deference in Investor-State Arbitration*, 4 J. INT’L DISP. SETTLEMENT 197 (2013).

¹³² See generally *id.*

¹³³ Lieb, *supra* note 111, at 58 (referring to this method, each of the disputing competent authorities will make their own dispute resolution proposals, and the arbitral tribunal will pick one from the two submissions).

terms of references, which contain the unresolved issues.¹³⁴ This also protects national interests, which is discussed in more detail below.

First, with regard to the accession to the MAP process, arbitration can only be initiated when one of the competent authorities requires it.¹³⁵ In this respect, the related competent authorities can control the taxation to some extent. There may be various reasons why a state might not want to make a claim against another state due to diplomatic relations.¹³⁶ Additionally, it does not matter whether a tax-related dispute falls under the OECD Model Convention or the U.N. Model Convention because MAP is essential to resolving the dispute.¹³⁷ Arbitration is a complementary part of MAP.¹³⁸ As a result, based on the OECD Model Convention, if the competent authorities can resolve all disputes during the MAP process, then arbitration will not start.¹³⁹ That means that parties can only initiate arbitration when some disputes cannot be resolved during the MAP process. If the disputes cannot be resolved during the MAP process but can be solved during the arbitration procedure by MAP, the arbitration process ends.¹⁴⁰ However, under certain circumstances, mandatory arbitration cannot be used even when unresolved disputes remain after the MAP process.¹⁴¹ Under Section 25(3) of the OECD Model Convention, mandatory arbitration can only resolve tax-related disputes that actually happened.¹⁴² In contrast, under the MAP submission requirement, taxpayers can submit a dispute to the competent authorities so long as there is a possibility that the dispute might

¹³⁴ See generally Carlo Garbarino & Marina Lombardo, *Arbitration of Unresolved Issues in Mutual Agreement Cases: The New Para. 5, Art. 25 of the OECD Model Convention, a Multi-Tiered Dispute Resolution Clause*, in TAX TREATIES: BUILDING BRIDGES BETWEEN LAW AND ECONOMICS 459 (Michael Lang et al. eds., 2010).

¹³⁵ UNITED NATIONS, DEP'T OF ECON. & SOC. AFFAIRS, MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES 11 (2017) [hereinafter U.N. 2017].

¹³⁶ Chaisse, *Investor-State*, *supra* note 19, at 170.

¹³⁷ See generally LANG & OWENS, *supra* note 27.

¹³⁸ ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), COMMENTARIES ON THE ARTICLES OF THE MODEL TAX CONVENTION 2017 370 (2017) [hereinafter OECD MODEL COMMENTARIES 2017].

¹³⁹ OECD MODEL CONDENSED 2017, *supra* note 106.

¹⁴⁰ See OECD MODEL COMMENTARIES 2017, *supra* note 138.

¹⁴¹ See *id.* at 372.

¹⁴² See OECD MODEL CONDENSED 2017, *supra* note 106.

happen.¹⁴³ As a result, if the unresolved disputes are caused by a threat or possibility of a threat, the unresolved disputes cannot be submitted to the arbitral tribunal.¹⁴⁴ At the same time, it does not matter whether the taxpayers are satisfied with the final agreement reached by the competent authorities through the MAP process.¹⁴⁵ Even if the taxpayers are unsatisfied with the result, they cannot initiate arbitration.¹⁴⁶ However, taxpayers can use local remedies for help—such as litigation or mediation.¹⁴⁷

Moreover, local litigation controls tax-related arbitration and is representative of state sovereignty.¹⁴⁸ Taxpayers can only initiate arbitration when unresolved disputes remain after the MAP process.¹⁴⁹ However, if a local court or administrative panel resolves the disputes, taxpayers cannot initiate arbitration.¹⁵⁰ When a local court resolves a dispute, the legitimacy of the local court's award is protected in case it is against the final award made by the independent third party such as an arbitral tribunal.¹⁵¹ In the 2010 OECD sample mutual agreement on arbitration, the request for arbitration is accompanied by statements indicating that no domestic court or administrative body in either contracting state has rendered a decision.¹⁵² This also protects national interest by avoiding potential conflicts between the arbitral award and local decisions.¹⁵³

¹⁴³ See ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), MODEL TAX CONVENTION ON INCOME AND CAPITAL ART. 25(1) (2010) [hereinafter OECD MODEL 2010].

¹⁴⁴ See generally *id.*

¹⁴⁵ OECD MODEL COMMENTARIES 2017, *supra* note 138, at 371.

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 375.

¹⁴⁸ *Id.*

¹⁴⁹ See OECD MODEL CONDENSED 2017, *supra* note 106.

¹⁵⁰ Kollmann & Turcan, *supra* note 87, at 121.

¹⁵¹ See generally Julien Chaisse, *The Shifting Tectonics of International Investment Law-Structure and Dynamics of Rules and Arbitration on Foreign Investment in the Asia-Pacific Region*, 47 GEO. WASH. INT'L L. REV. 563 (2015); U.N. Conference on Trade and Dev., *IIA Issues Note: Recent Trends in IIAs and ISDS*, No. 1 (Feb. 2015), http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d1_en.pdf; Julien Chaisse & Rahul Donde, *The State of Investor-State Arbitration: A Reality Check of the Issues, Trends, and Directions in Asia-Pacific*, 51 INT'L LAW. 47 (2018).

¹⁵² Kollmann & Turcan, *supra* note 87, at 121.

¹⁵³ See generally OECD MODEL 2010, *supra* note 143.

Second, mandatory arbitration in tax matters is still confidential between the contracting states.¹⁵⁴ Because the entire arbitration process and most of the materials are confidential, state sovereignty is protected.¹⁵⁵ Furthermore, the decisions reached under the MAP process are often not public in individual cases.¹⁵⁶ Only when both competent authorities and the taxpayers agree on publication can a part of the final arbitral award be published, but the award contains none of the disputing parties' identifying information.¹⁵⁷ Thus, competent authorities can control the publication. Even though this lacks transparency, this control is beneficial for the national interest. However, if full decisions are published, a subsequent arbitral tribunal may consider the award when faced with the same issues.¹⁵⁸ As a result, if the competent authorities lose the case, it is more likely they will lose again when faced with the same issues.¹⁵⁹ If the awards are confidential, the arbitral tribunal should consider the facts on a case-by-case basis to protect the interests of the competent authorities.

Third, there is a unified organization to hold and decide the case in mandatory arbitration under BITs.¹⁶⁰ Yet no unified organization exists to hold and decide the tax-related disputes under bilateral tax treaties.¹⁶¹ In this situation, the baseball arbitration preferred by the United States government can be a good choice. Unlike the normal independent arbitral tribunal, which considers cases and makes decisions independently, the arbitral tribunal in baseball arbitration lacks discretion to make its own decisions.¹⁶² Instead, each of the disputing competent authorities submits its own dispute resolution proposal, and then the arbitral tribunal will pick one from the two submissions.¹⁶³ If one competent authority wants its proposal to win, it

¹⁵⁴ OECD MODEL COMMENTARIES 2017, *supra* note 138, at 383.

¹⁵⁵ ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), 2017 UPDATE TO THE OECD MODEL CONVENTION 216 (2017) [hereinafter OECD UPDATE].

¹⁵⁶ See generally U.N. Comm'n on Int'l Trade Law, *UNCITRAL Rules on Transparency in Treaty-Based Investor-State Arbitration*, 11 (Jan. 2014), <http://www.uncitral.org/pdf/english/texts/arbitration/rules-on-transparency/Rules-on-Transparency-E.pdf>.

¹⁵⁷ OECD UPDATE, *supra* note 155, at 215.

¹⁵⁸ See J. Scott Wilkie, *Implementation of Arbitration Decisions in Domestic Law*, in INTERNATIONAL ARBITRATION IN TAX MATTERS 826 (2016).

¹⁵⁹ *Id.*

¹⁶⁰ See generally, e.g., DOLZER & SCHREUER, *supra* note 10.

¹⁶¹ See generally LANG & OWENS, *supra* note 27.

¹⁶² *What Is Baseball Arbitration?*, ARBITRATION.COM (June 9, 2011), <http://www.arbitration.com/articles/what-is-baseball-arbitration.aspx>.

¹⁶³ *Id.*

cannot be too biased or self-interested.¹⁶⁴ On the contrary, it must reach a balance between the disputing competent authorities.¹⁶⁵ And as the proposal is entirely put forward by the competent authorities themselves, without input from a third party, baseball arbitration protects state sovereignty and balances the interests of the two contracting states.

Finally, the contracting states can narrow the scope of disputes arbitration can affect.¹⁶⁶ For instance, in the OECD Model Convention, there is a difference between the MAP and mandatory arbitration related to the initiative reasons.¹⁶⁷ In terms of the MAP process, taxpayers can initiate it when there is actual damage to their investment or if damage is likely to happen.¹⁶⁸ That means that as long as the taxpayers suppose there is a possibility of damage, they can initiate a request to the competent authorities to start the MAP process. However, arbitration can only be initiated when there is an actual result that is not in accordance with the treaties between the contracting states.¹⁶⁹ In other words, an actual result is required for mandatory arbitration in tax matters. Article 25 of the OECD Model Convention illustrates that only disputes related to paragraphs 1 and 2 can be covered in paragraph 5, which is mandatory binding arbitration.¹⁷⁰ If a dispute is related to paragraph 3, which standardizes the interpretations of regulations in bilateral tax treaties and mutually resolves disputes that are not explicitly regulated in the tax-related treaties, arbitration cannot be initiated.¹⁷¹ This also protects national sovereignty because the competent authorities can interpret the bilateral tax treaties for their benefit without being afraid of intervention from the independent, third-party arbitral tribunal. Furthermore, if disputes arise because of policies promulgated by the host states related to their national interests, those interests should be excluded from the scope that tax-related arbitration can cover.¹⁷² This can be clearly written in the

¹⁶⁴ Jeff Monhait, *Baseball Arbitration: An ADR Success*, 4 HARV. J. SPORTS & ENT. L. 105, 132 (2013).

¹⁶⁵ Lieb, *supra* note 111, at 58–59.

¹⁶⁶ See generally Kollmann & Turcan, *supra* note 87, at 123.

¹⁶⁷ See generally OECD MODEL CONDENSED 2017, *supra* note 106, at 429–86.

¹⁶⁸ See OECD MODEL COMMENTARIES 2017, *supra* note 138.

¹⁶⁹ *Id.* at 372.

¹⁷⁰ *Id.*

¹⁷¹ See generally Kollmann & Turcan, *supra* note 87, at 120.

¹⁷² See generally *id.* at 127.

bilateral tax treaties.¹⁷³ For example, protection of the environment is a significant national interest, and disputes related to it should not be decided by the third party.¹⁷⁴ Moreover, some criteria should not be applied. For instance, the Most Favored Nation (MFN) criterion should be prohibited in application so that the states still control the arbitration. The mandatory arbitration clause should be negotiated on a case-by-case and state-by-state basis.

Because a bilateral tax treaty is essentially a contract, the contracting competent authorities should decide upon and control all aspects of the bilateral tax treaty.¹⁷⁵ As a result, the competent authorities can explicitly make some regulations related to mandatory arbitration, such as the scope it can cover and how it will proceed. For example, the arbitrators can decide the rules for implementing arbitration procedures by themselves, which means that they can resort to the rules of the available institutions.¹⁷⁶ If the competent authorities have reached an agreement on the procedural requirements, the arbitral tribunal should adhere to that agreement.¹⁷⁷ For example, in the 2010 OECD Model Convention, “the procedural rules provided for in the sample agreement shall apply unless the competent authorities provide otherwise in the Terms of Reference.”¹⁷⁸ Therefore, “it is possible for the competent authorities, through the Terms of Reference, to depart from any of these rules or to provide for additional rules in a particular case.”¹⁷⁹ This means that the competent authorities can control the arbitration procedures to some extent, which in turn allows them to protect their national interests. Although it is within the competent authorities’ discretion to decide the Terms of Reference and limit them in a particular issue or set of disputes, they can draft the Terms of Reference to include the entire case and all the issues related with the consent of both authorities.¹⁸⁰ They are free to make the decision.

¹⁷³ See generally LANG & OWENS, *supra* note 27.

¹⁷⁴ See generally *id.*

¹⁷⁵ Brian J. Arnold, *The Scope of Arbitration Under Tax Treaties*, in INTERNATIONAL ARBITRATION IN TAX MATTERS 124 (2016).

¹⁷⁶ See generally ZVI DANIEL ALTMAN, DISPUTE RESOLUTION UNDER TAX TREATIES 323 (2006).

¹⁷⁷ See Arnold, *supra* note 175.

¹⁷⁸ OECD MODEL 2010, *supra* note 143, at C(25)-45.

¹⁷⁹ *Id.* at R(21)-25.

¹⁸⁰ *Id.*

The degree of the taxpayer's involvement depends on the discretionary power of the competent tax authorities.¹⁸¹ For example, only once both the arbitrators and competent authorities agree during arbitration can the taxpayers then make an oral statement during the process.¹⁸² From the OECD Model Convention, the taxpayers are excluded from the arbitration process as a claimant.¹⁸³ The whole arbitral process is a state versus state case, and the two contracting states may drop a case because of political or diplomatic concerns.¹⁸⁴ After the arbitral tribunal reaches an award, the competent authorities should reach a mutual agreement to implement it.¹⁸⁵ The 2017 OECD Model Convention states, "The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph."¹⁸⁶ Simply put, the disputing competent authorities control the method for invoking the award.

In addition, the competent authorities can still protect their national sovereignty once the arbitration has commenced, as long as the final award is not delivered to them. Most states will not allow a person to simultaneously pursue the MAP process and domestic legal remedies.¹⁸⁷ Some states, however, allow a person to simultaneously pursue both the MAP process and proceedings before a court or administrative tribunal for the same issue.¹⁸⁸ In those states, a court or administrative tribunal may issue a decision after a request for arbitration has been made but before the arbitral panel delivers its decision.¹⁸⁹ In this situation, the arbitration process may be terminated to avoid difficulties that may arise when applying the mutual agreement in implementing a subsequent arbitration decision.¹⁹⁰ In this situation, both the arbitration and the MAP process can be treated as not having

¹⁸¹ See generally OECD MODEL CONDENSED 2017, *supra* note 106, at 481.

¹⁸² *Id.* at 471.

¹⁸³ See *id.* at 470–72.

¹⁸⁴ CHAISSE & THE E15, *supra* note 49, at 10.

¹⁸⁵ OECD MODEL CONDENSED 2017, *supra* note 106, at 44.

¹⁸⁶ *Id.* at 45.

¹⁸⁷ *Id.* at 459.

¹⁸⁸ Kollmann & Turcan, *supra* note 87, at 87.

¹⁸⁹ Chaisse, *BEPS*, *supra* note 33, at 19.

¹⁹⁰ ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), MODEL TAX CONVENTION ON INCOME AND ON CAPITAL: FULL VERSION 2017, C(25)-41 (2017).

been initiated at all.¹⁹¹ Furthermore, the 2014 OECD sample mutual agreement on arbitration provides that

notwithstanding paragraphs 6, 15, 16 and 17, where, at any time after a request for arbitration has been made and before the arbitrators have delivered a decision to the competent authorities, and the person who made the request for arbitration, the competent authorities must notify in writing the arbitrators and that person that they have solved all the unresolved issues described in the Terms of Reference, the case shall be considered as solved under the mutual agreement procedure and no arbitration decision shall be provided.¹⁹²

“This agreement applies to any request for arbitration made pursuant to paragraph 5 of Article 25 of the Convention.”¹⁹³

Even if the arbitral tribunal has reached the arbitration award, the competent authorities can still protect their national interests. For example, according to the 2017 U.N. Model Convention, the competent authorities can reach a different agreement within six months of the arbitration award.¹⁹⁴ An arbitration decision is “binding on both States and shall be implemented notwithstanding any time limits in the domestic laws of these States unless both competent authorities agree on a different solution within six months after the decision has been communicated to them.”¹⁹⁵ Because of this provision, the competent authorities can better protect their interests. According to paragraph 18 of the OECD Sample Mutual Agreement on Arbitration, the courts of one of the contracting states may find the arbitration decision unenforceable.¹⁹⁶ Where a contracting state finds a decision is unenforceable, “the request for arbitration shall be considered not to have been made and the arbitration process shall be considered not to have taken place.”¹⁹⁷ Thus, the time limit in the domestic laws does not affect implementation of the final arbitral award, so the contracting states still have options to restrict an award’s implementation if it violates the national interest of one of the contracting states.¹⁹⁸ As opposed to the implementation of arbitral awards under BITs, there are

¹⁹¹ *Id.*

¹⁹² ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), MODEL TAX CONVENTION ON INCOME AND ON CAPITAL: CONDENSED VERSION 2014, 404 (2014).

¹⁹³ *Id.*

¹⁹⁴ U.N. 2017, *supra* note 135, at 38.

¹⁹⁵ *Id.*

¹⁹⁶ See OECD MODEL 2010, *supra* note 143, at ¶ 18.

¹⁹⁷ *Id.*

¹⁹⁸ Kollmann & Turcan, *supra* note 87, at 143.

no consequences if the losing contracting state does not follow the arbitral decision. When it comes to international tax law arbitral decision enforcement, Article 25(5) of the OECD Model Convention states, “Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States.”¹⁹⁹ Under the OECD Model Convention, the implementation of an arbitral award relies on the mutual agreement reached by the competent authorities.²⁰⁰ Consequently, the competent authorities can control how the arbitral award is implemented to some extent.

Finally, the binding effect of the arbitration decision is limited to the issues submitted to arbitration and to the specifics of the case presented to the competent authorities.²⁰¹ The contracting states are not bound by the arbitration decision with regard to future taxable years or with regard to different taxpayers.²⁰² Arbitration decisions cannot be treated as precedent.²⁰³

III WHY TAXPAYERS TEND TO CHOOSE MANDATORY ARBITRATION OVER MAP

In bilateral tax treaties, there are two kinds of dispute resolution methods.²⁰⁴ One is MAP, and the other is the mandatory arbitration clause.²⁰⁵ Although some countries have incorporated the mandatory arbitration clause in their treaties, MAP dominates as the main resolution method for tax-related disputes and is more favorable to the contracting states.²⁰⁶ Based on the 14 Action Report, several measures have been initiated to ensure the MAP process is efficient.²⁰⁷ However, taxpayers tend to rely on the mandatory arbitration clause as the

¹⁹⁹ OECD MODEL CONDENSED 2008, *supra* note 117, at 38.

²⁰⁰ *Id.*

²⁰¹ Chaisse, *Investor-State*, *supra* note 19, at 152.

²⁰² CHAISSE & THE E15, *supra* note 49.

²⁰³ OECD MODEL CONDENSED 2017, *supra* note 106, at 471.

²⁰⁴ *See generally id.*

²⁰⁵ *See generally id.*

²⁰⁶ *See generally* LANG & OWENS, *supra* note 27.

²⁰⁷ *Public Discussion Draft BEPS Action 14*, *supra* note 26, at 4–5.

preferred method for tax-related disputes for several reasons, as described below.²⁰⁸

A. Taxpayers Enjoy More Rights with Mandatory Arbitration

Foreign investors will be more confident with tax-related arbitration than the MAP process because they have more rights under mandatory arbitration.²⁰⁹ Under the OECD Model Convention, foreign investors have the right to initiate arbitration instead of the competent authorities.²¹⁰ As long as there are unresolved disputes after the MAP process, foreign investors can require mandatory arbitration after a written request.²¹¹ However, the decision to initiate the MAP process is controlled by the competent authorities.²¹² As long as the disputes can be resolved unilaterally, regardless of whether the taxpayers are satisfied, the MAP process cannot proceed.²¹³ What is worse, some states put barriers on the accession to the MAP process.²¹⁴ For example, if these disputes have been submitted to litigation or to the administrative tribunal, the MAP process cannot proceed until an award is issued.²¹⁵ Furthermore, the MAP process can only be initiated once both competent authorities receive the taxpayers' full information.²¹⁶ However, when either or both competent authorities deem that the information is incomplete, the taxpayers have no choice but to resubmit more related information.²¹⁷ This illustrates the powerful control the competent authorities have over access to the MAP process. It should be emphasized that the taxpayers are not a party to the arbitration procedure, as it is a procedure between the competent authorities.²¹⁸ However, having the taxpayers involved in the dispute resolution process to some extent may be beneficial because taxpayers can provide some evidence to help protect their benefits. With the approval of arbitral tribunal and competent authorities, taxpayers

²⁰⁸ Chaisse, *Investor-State*, *supra* note 19.

²⁰⁹ *See generally* LANG & OWENS, *supra* note 27.

²¹⁰ OECD MODEL CONDENSED 2017, *supra* note 106, at 453.

²¹¹ *Id.*

²¹² *Id.* at 429.

²¹³ Kollmann & Turcan, *supra* note 87, at 94.

²¹⁴ Chaisse, *BEPS*, *supra* note 33, at 6.

²¹⁵ OECD MODEL CONDENSED 2017, *supra* note 106, at 45.

²¹⁶ OECD MODEL COMMENTARIES 2017, *supra* note 138, at 366.

²¹⁷ *See generally* LANG & OWENS, *supra* note 27.

²¹⁸ *Id.*

can make an oral statement.²¹⁹ In addition, the 2008 OECD Model Convention provides that taxpayers can veto the award reached by the arbitral tribunal if they are unsatisfied with it.²²⁰ The Model Convention states, “Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, such decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States.”²²¹ This means that the taxpayers can control the arbitration to some extent, which better protects their interests.

B. Mandatory Arbitration Can Make Up for MAP's Shortcomings

Foreign investors invest more in countries with tax-related mandatory arbitration because it addresses many shortcomings in the MAP process.²²² For one thing, the MAP process only requires the competent authorities to “endeavor” to try their best to resolve disputes.²²³ Therefore, no particular result is required.²²⁴ No matter whether the dispute is totally resolved, partly resolved, or unresolved, the competent authorities will not be blamed.²²⁵ Moreover, some competent authorities do not come to the table in good faith and refuse to change their aggressive or unreasonable positions.²²⁶ While the BEPS Action 14 includes a minimum requirement to “ensure the treaty obligations related to the mutual agreement procedure are fully implemented in good faith and the MAP cases are resolved in a timely manner,” the measures to achieve this standard are not particularly functional.²²⁷ As a result, the competent authorities must consider the benefits of taxpayers involved more in mandatory arbitration, rendering the MAP process more efficient in some situations.²²⁸

However, there are no follow-up measures to implement the result even if it is reached. Although the result reached by the competent

²¹⁹ U.N. 2011, *supra* note 115, at 433.

²²⁰ OECD MODEL CONDENSED 2008, *supra* note 117, at 38.

²²¹ *Id.*

²²² *See generally* Kollmann & Turcan, *supra* note 87, at 164.

²²³ OECD MODEL 2014, *supra* note 19.

²²⁴ OECD MODEL CONDENSED 2017, *supra* note 106, at 429.

²²⁵ Chaisse, *BEPS*, *supra* note 33, at 19.

²²⁶ *Id.* at 6.

²²⁷ OECD ACTION 14: 2015 FINAL REPORT, *supra* note 21, at 9.

²²⁸ *See generally* LANG & OWENS, *supra* note 27.

authorities is binding, if the losing party does not obey the award, there are no follow-up measures to punish the losing party.²²⁹ In addition, the investors cannot reach arbitration before the MAP process ends.²³⁰ This process is not only time-consuming but also has an adverse effect on the management of investments.²³¹ Under the OECD Model Convention, the MAP process should be completed in two years.²³² Yet under the U.N. Model Convention, the period is extended to three years.²³³ In practice, MAP is not fair for a specific foreign investor because the competent authorities will not initiate the MAP process for only one case.²³⁴ In contrast, foreign investors will make use of the MAP process to resolve a group of cases as a whole so that the contracting competent authorities can simultaneously decide that group of cases.²³⁵ In this process, the justice of one specific case will not be protected, and the profits of one specific taxpayer are more likely to be sacrificed for the interests of the state.²³⁶ Finally, there is a situation where each competent authority treats its interpretation of tax convention as correct and the opposing competent authority's interpretation as incorrect.²³⁷ With MAP, this kind of situation will be less likely to be resolved than with mandatory arbitration.²³⁸ Mandatory arbitration can resolve this dilemma for the benefit of all the stakeholders without contradicting the global trends.

Foreign taxpayers chase stable investing environments, and tax-related mandatory arbitration can provide the certainty necessary for investment. This is because arbitration can make up for MAP's shortcomings in resolving tax-related disputes for the following reasons.

First, arbitration is less biased compared to MAP.²³⁹ Because the MAP process is completely controlled by the competent authorities, the profits of taxpayers are inevitably ignored when there is a need to

²²⁹ Chaisse, *BEPS*, *supra* note 33, at 24.

²³⁰ *Id.* at 22.

²³¹ *Id.* at 21–22.

²³² OECD MODEL 2014, *supra* note 19.

²³³ U.N. 2011, *supra* note 115, at 30.

²³⁴ *See generally* LANG & OWENS, *supra* note 27.

²³⁵ Luciana Nobrega & Silva Loureiro, *Mutual Agreement Procedure: Preventing the Compulsory Jurisdiction of the International Court of Justice?*, 37 *INTERTAX* 539 (2009).

²³⁶ *Id.*

²³⁷ *See generally* LANG & OWENS, *supra* note 27.

²³⁸ *See generally id.*

²³⁹ *See generally id.*

balance the national interests between the contracting states.²⁴⁰ The arbitral tribunal, however, is more independent.²⁴¹ To illustrate this point, the OECD Model Sample states that

each arbitrator must, at the time of accepting his or her appointment, be impartial and independent of the competent authorities, tax administrations, and ministries of finance (or relevant equivalent ministries or departments, regardless of their name) of the Contracting States, as well as all persons directly affected by the case and their advisors. Each arbitrator must also maintain his or her impartiality and independence throughout the proceedings, and must, for a reasonable period of time thereafter, avoid conduct that may damage the appearance of impartiality and independence of the arbitrators with respect to the proceedings.²⁴²

Second, because the contracting states are concerned about their state sovereignty, they are more likely to reach an agreement during the MAP process, thereby increasing the efficiency of MAP to some extent.²⁴³ For example, the two-year period of the MAP process is not fixed.²⁴⁴ For one thing, the taxpayers who present their case can request a suspension of the MAP process, and the two-year period can be suspended after the competent authorities agree to it.²⁴⁵ For another, the competent authorities can suspend the two-year period if they have to wait for an award pending with the court or administrative organization.²⁴⁶ Most importantly, if the competent authorities decide to suspend the MAP process because the two-year period is too short, they do so and inform the taxpayers who presented the case.²⁴⁷ In this situation, the taxpayers have no control over the decision to suspend the MAP process and only receive a notification.²⁴⁸ The competent authorities can also suspend the two-year period without reasonable arguments, and mandatory arbitration can push the competent authorities to resolve the disputes more quickly.²⁴⁹

²⁴⁰ See Kollmann & Turcan, *supra* note 87, at 93.

²⁴¹ Chaisse, *BEPS*, *supra* note 33, at 25.

²⁴² OECD MODEL CONDENSED 2017, *supra* note 106, at 209.

²⁴³ See generally Kollmann & Turcan, *supra* note 87, at 112.

²⁴⁴ See OECD MODEL CONDENSED 2017, *supra* note 106, at 456–57.

²⁴⁵ See *id.*

²⁴⁶ *Id.*

²⁴⁷ See *id.* at 456.

²⁴⁸ See *id.*

²⁴⁹ See generally LANG & OWENS, *supra* note 27.

Finally, a taxpayer can enjoy more profits after the arbitral award has been made. First, if the taxpayers are not satisfied with the arbitration award, they have veto power and can reach local remedies.²⁵⁰ Taxpayers do not have to explicitly express their veto power.²⁵¹ The movements of taxpayers can illustrate an arbitral award's rejection.²⁵² For instance, if the taxpayers do not terminate the resolved issues from the local court or administrative tribunal, this is treated as an objection that stops the award from proceeding.²⁵³ Second, if the taxpayers accept the award, both of the disputing competent authorities are bound by it.²⁵⁴ The competent authorities must reach a mutual agreement to implement the arbitral award.²⁵⁵ Last, there is no time limit in implementing the award regardless of the domestic regulations.²⁵⁶

IV OTHER BENEFITS OF MANDATORY ARBITRATION CLAUSES IN TAX MATTERS

Arbitration can not only make up for the shortcomings of MAP but can also benefit taxpayers and states because the cost of litigation is avoided. Section 25(5) of the OECD Model Convention provides that if disputes are resolved by litigation, arbitration cannot be initiated—regardless of whether the litigation was in domestic or international court.²⁵⁷ However, because litigation is time- and money-consuming, it is not ideal for taxpayers, especially when they want a speedy resolution. Furthermore, with limited resources and a lack of qualified staff, a domestic court is unlikely to be as professional as a mandatory arbitral tribunal.²⁵⁸ As a result, even if the lower court has already made an award, taxpayers are not prohibited from reaching for mandatory arbitration as an alternative dispute resolution method.²⁵⁹

Taxpayers always prefer mandatory arbitration in tax matters, and there are some instances where the competent authorities also like to

²⁵⁰ OECD MODEL 2014, *supra* note 19, at 60–61.

²⁵¹ *See* OECD MODEL CONDENSED 2017, *supra* note 106, at 459.

²⁵² *See id.*

²⁵³ *See* OECD MODEL COMMENTARIES 2017, *supra* note 138, at 377.

²⁵⁴ OECD MODEL 2014, *supra* note 19.

²⁵⁵ *Id.*

²⁵⁶ *Id.*

²⁵⁷ OECD MODEL 2010, *supra* note 143.

²⁵⁸ *See generally* LANG & OWENS, *supra* note 27.

²⁵⁹ *See* Chaisse, *BEPS*, *supra* note 33, at 24.

make use of it. For the competent authorities, MAP is always preferable to mandatory binding tax-related arbitration because it helps them maintain their relationship with the taxpayers.²⁶⁰ However, there may be some situations where taxpayers face some controversial or sensitive issues and, accordingly, prefer to resolve them outside of the MAP process.²⁶¹ In these situations, mandatory arbitration can be a good choice for the taxpayers.

V

CHINA SHOULD ADOPT A MIXED ARBITRATION SYSTEM

There are two kinds of arbitration. One is institutional arbitration, and the other is *ad hoc* arbitration.²⁶² Arbitration in tax matters is *ad hoc* arbitration. This means that one specific group of arbitrators will focus on one specific case.²⁶³ Faced with each case, the competent authorities can reach a specific Term of Reference in proceeding with the arbitration.²⁶⁴

There are two kinds of arbitration used in resolving tax-related disputes: (1) baseball or “last best offer” arbitration, and (2) independent arbitration.²⁶⁵ The OECD Model Convention commentaries provide for both kinds of arbitration, and competent authorities may choose to use either one.²⁶⁶ However, baseball arbitration is mainly initiated by the government of the United States but is otherwise seldom used.²⁶⁷

With baseball arbitration, each contracting state proposes an offer to resolve the dispute, and the panel of arbitrators must choose from the two offers.²⁶⁸ In other words, the panel cannot decide the case by itself.

²⁶⁰ See generally Arnold, *supra* note 175, at 305.

²⁶¹ *Id.* at 307.

²⁶² Carita Wallgren-Lindholm, *Ad Hoc Arbitration v. Institutional Arbitration*, in INTERNATIONAL COMMERCIAL ARBITRATION: DIFFERENT FORMS AND THEIR FEATURES 61, 61 (Giuditta Cordero-Moss ed., 2013).

²⁶³ See generally Maya Ganguly, *Tribunals and Taxation: An Investigation of Arbitration in Recent US Tax Conventions*, 29 WIS. INT'L L.J. 735 (2012).

²⁶⁴ Kollmann & Turcan, *supra* note 87, at 110.

²⁶⁵ See OECD MODEL CONDENSED 2017, *supra* note 106, at 474.

²⁶⁶ See *id.*

²⁶⁷ See generally Josh Chetwynd, *Play Ball? An Analysis of Final-Offer Arbitration, Its Use in Major League Baseball and Its Potential Applicability to European Football Wage and Transfer Disputes*, 20 MARQ. SPORTS L. REV. 109 (2009).

²⁶⁸ Lieb, *supra* note 111, at 58.

The most significant benefit of baseball arbitration is its efficiency. The competent authorities can give some guidance to efficiently implement the arbitration clause.²⁶⁹ For instance, the United States government has created many detailed guidelines in its tax treaty with Canada.²⁷⁰ The United States-Canada tax treaty not only provides clear deadlines for the submissions made by the competent authorities, but it also provides a maximum page count for each individual document.²⁷¹ Additionally, the powers of the chair of the arbitral tribunal are limited when it comes to requiring additional information.²⁷²

Another advantage of baseball arbitration is that it is much cheaper than independent arbitration. Because baseball arbitration does not require reasoning and is based on tax treaties, the entire process is shorter and speedier.²⁷³ As a result, it requires only a limited number of hearings.²⁷⁴ For the board of arbitrators, technological methods such as emails or videos are recommended for communicating.²⁷⁵ Except for extraordinary circumstances, face-to-face meetings are not needed.²⁷⁶ All of these aspects of baseball arbitration lead to a cheaper award.²⁷⁷

However, baseball arbitration requires experienced and competent authorities. The panel of arbitrators must choose one proposal from the two submissions, and it will try to reach a balance by picking the least extreme option.²⁷⁸ Developed states are more familiar with the procedures and principles of baseball arbitration, while developing states may submit more extreme proposals that are most suitable for their own benefit due to a lack of experience.²⁷⁹ As a result, regardless of which kind of arbitration is used, both the developed and developing states need an experienced staff to implement arbitration.

Independent arbitration is mainly used and accepted as a method for tax dispute resolution.²⁸⁰ The arbitral tribunal decides the case on its

²⁶⁹ See Can.-U.S. Tax Convention, *supra* note 64.

²⁷⁰ See generally *id.*

²⁷¹ See *id.*

²⁷² See *id.*

²⁷³ See Chetwynd, *supra* note 267, at 128.

²⁷⁴ See Kollmann & Turcan, *supra* note 87, at 130.

²⁷⁵ See Can.-U.S. Memorandum of Understanding, *supra* note 125.

²⁷⁶ *Id.*

²⁷⁷ See *id.*

²⁷⁸ Kollmann & Turcan, *supra* note 87, at 107.

²⁷⁹ See generally LANG & OWENS, *supra* note 27.

²⁸⁰ See OECD MODEL COMMENTARIES 2017, *supra* note 138, at 387.

own, and the final award is unaffected by competent authorities.²⁸¹ With more professional and less biased arbitrators, the final award can be more reliable.²⁸² A significant difference between baseball and independent arbitration is that independent arbitration requires a written opinion.²⁸³ The OECD commentary even emphasizes the importance of the written award, arguing that it will be much easier for the taxpayers to accept the opinion when they know the methods through which the arbitrators reached their decision.²⁸⁴ Although it has no formal precedential value, a written opinion can be a reference point for subsequent arbitrators when they encounter similar issues.²⁸⁵

China should develop a mixed arbitration system. For resolving simple and obvious disputes over small amounts of money, China should use baseball arbitration. Because of its efficiency, baseball arbitration is the most suitable form of arbitration for uncomplicated disputes. Furthermore, this method is a proper way to balance the interests of both competent authorities without destroying the relationship between them. When faced with more complex disputes, China should use independent arbitration. In these situations, the arbitral tribunal can analyze the case based on all materials that the competent authorities and taxpayers have submitted and make the final award. Independent arbitration is a great way for developing states, like China, to become more familiar with international standards. As a result of increased familiarity, China can improve its domestic certainty and attract more FDI.

According to the OECD Model Convention, the arbitration award is binding for both competent authorities.²⁸⁶ The binding effect means that the competent authorities have to accept the arbitration as a dispute resolution method when they cannot resolve disputes during the MAP process.²⁸⁷ The binding effect also means that an arbitral award is

²⁸¹ *Id.*

²⁸² See generally LANG & OWENS, *supra* note 27.

²⁸³ Raffaele Petruzzi et al., *Baseball Arbitration in Comparison to Other Types of Arbitration*, in INTERNATIONAL ARBITRATION IN TAX MATTERS 141 (2016).

²⁸⁴ See OECD MODEL COMMENTARIES 2017, *supra* note 138, at 387.

²⁸⁵ OECD MODEL CONDENSED 2017, *supra* note 106, at 472.

²⁸⁶ OECD MODEL 2014, *supra* note 19, at 39.

²⁸⁷ See *id.*

binding only if the taxpayers reject the award.²⁸⁸ In this situation, the binding effect of the arbitral awards can give more confidence to foreign taxpayers.

One fundamental reason for establishing a special economic zone (SEZ) is to develop the economy of a specific region within a single jurisdiction.²⁸⁹ China can utilize SEZs as an experimental forum to test new policies.²⁹⁰ The term SEZ includes free trade zones (FTZs), which lie outside the host state's customs territory.²⁹¹ In FTZs, certain goods enjoy tax exemptions.²⁹² China can experiment with mandatory arbitration in tax matters in some FTZs of mainland China. If China implements the mixed arbitration system well, it can regulate the system with a statute and use the system across the country. If the mixed arbitration system does not function well, China can improve the system.

Implementing mandatory arbitration in FTZs has several advantages. First, controlling the implementation and scope of arbitration is easier in FTZs compared to all of China.²⁹³ The corporations in FTZs are more powerful and can be great advocates for mandatory arbitration.²⁹⁴ Additionally, FTZs have a great number of highly educated and experienced staff members who are more qualified than the staff in less developed places.²⁹⁵ Thus, staff members in FTZs may be more qualified to resolve tax-related disputes. The core policies

²⁸⁸ See ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), ARTICLES OF THE MODEL CONVENTION WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL 22 (2017).

²⁸⁹ Julien Chaisse & Jiaxiang Hu, *International Economic Law and the Challenges of Economic Zones: An Introduction*, in INTERNATIONAL ECONOMIC LAW AND THE CHALLENGES OF THE FREE ZONES 2 (Julien Chaisse and Jiaxiang Hu eds., 2019).

²⁹⁰ Michael R. Castle Miller, *The Ciudades Modelo Project: Testing the Legality of Paul Romer's Charter Cities Concept by Analyzing the Constitutionality of the Honduran Zones for Employment and Economic Development*, 22 WILLAMETTE J. INT'L L. & DISP. RESOL. 271, 277–78 (2014).

²⁹¹ SEAN WOOLFREY, SPECIAL ECONOMIC ZONES AND REGIONAL INTEGRATION IN AFRICA 3 (2013).

²⁹² *Id.*

²⁹³ See generally Xia Tang, 'Foreign Elements' in the Arbitration of China's Free Trade Zones, 5 CHINA & WTO REV. 63 (2019).

²⁹⁴ See generally *id.*

²⁹⁵ See Ramakrishna Nallathiga, *Potential of Special Economic Zones in Promoting Industrial and Regional Economic Development: An Analysis*, 4 IFCAI J. INDUS. ECON. 62, 72 (2007).

of FTZs include many favorable taxation measures.²⁹⁶ With the help of these taxation policies, areas around FTZs also benefit from their developments.²⁹⁷ In sum, China can experiment with these policy innovations in the FTZs and it can later implement them in the whole state once they are mature.

CONCLUSION

China should utilize two different kinds of arbitration for resolving tax-related disputes: baseball arbitration and independent arbitration. China should implement a mixed arbitration system. China should use baseball arbitration to resolve simple disputes and independent arbitration to resolve more complicated disputes. Before implementing this mixed arbitration system across the country, China can first test the system in SEZs. By starting only in SEZs, China can fix any defects in the system. Mandatory arbitration in tax matters is useful for resolving tax-related disputes.²⁹⁸ For one thing, if mandatory arbitration is applied, China can be seen by foreign investors and other countries as being committed to offering a predictable and secure investment regime.²⁹⁹ For another, mandatory arbitration “creates an incentive to develop domestic policies favorable to attracting new investment and maintaining ongoing investment, including policies that are predictable, certain, and transparent.”³⁰⁰ Based on the certainty it brings for taxpayers, mandatory arbitration can better protect foreign investors, attract more FDI, and, in the long term, foster a more sustainable economic development.

²⁹⁶ See Douglas Zihua Zeng, *How Do Special Economic Zones and Industrial Clusters Drive China's Rapid Development?*, in BUILDING ENGINES FOR GROWTH AND COMPETITIVENESS IN CHINA: EXPERIENCE WITH SPECIAL ECONOMIC ZONES AND INDUSTRIAL CLUSTERS 12 (Douglas Zihua Zeng ed., 2010).

²⁹⁷ See *id.*

²⁹⁸ See generally LANG & OWENS, *supra* note 27.

²⁹⁹ Julien Chaisse, *Arbitration in Tax Treaty Law and Arbitration Under Bilateral Investment Treaties*, in INTERNATIONAL ARBITRATION IN TAX MATTERS 955 (2016).

³⁰⁰ *Id.*

