A Critique of EU’s Double Standards on Dispute Resolution Mechanisms in Bilateral Investment Treaties and Double Taxation Treaties

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This post aims at highlighting an inconsistency in the law of the European Union (“EU”) in regards to the comparison of the treatment of Bilateral Investment Treaties (“BITs”) and Double Taxation Treaties (“DTTs”) concluded between EU Member States. The inconsistency lies in the diametrically different approaches adopted by EU law and its institutions (“EU Institutions”) towards the dispute resolution mechanisms contained in these international instruments.

Relationship Between BITs and DTTs

BITs and DTTs supplement each other towards the common goal of promotion of cross-border investments. Just as it would be unthinkable to invest in a foreign country at the risk of being taxed twice on the same by both the Residence State as well as the Source State, it is equally undesirable to invest in a foreign country at the risk of bearing any political risk inherent to such operation.

The two forms of arbitration provided under the BITs and DTTs differ formally in that BITs provide for Investor-State arbitrations as well as State-to-State arbitration, whereas DTTs enable arbitration prompted by the taxpayer between the two tax authorities of the Contracting Parties laying a claim to tax the same source of profit. However, BITs and DTTs share similar traits and numbers (with approximately three thousand DTTs around the world and as many BITs). Both represent a limitation on state sovereignty and make such limitation effective by including an arbitration agreement. Traditional state regulatory rights concerning the levy of taxes and what treatment to accord to aliens and their possessions are constrained by these instruments for the greater good of fostering foreign investment and improving global economy.

While the efficacy of the impact of these instruments on increase of cross-border investments *per se* may be disputed, what seems settled is that without DTTs there would be more tax evasion (presumably, justified by the perception of being unfairly taxed twice) and without BITs there would be more diplomatic protection cases revamping national protectionism all over the world (by way of comparison, it suffices to look at how international trade disputes are often ineffectively handled sometime with long-term consequences on global growth). It is also uncontested that both instruments have been playing a major role in harmonizing and strengthening the rule of law by

weaving a sort of international administrative law.

BITs are the products of bilateral negotiations where the Model BIT of each Party may blend with the other Party's Model, hence, each BIT may present unique provisions. DTTs are, instead, more standardized since their starting point is always the Model provided by the Organisation for Economic Co-operation and Development ("OECD").

The interaction between BITs and DTTs may vary considerably depending on the phrasing of their single provisions. Their reciprocal interplay may range from having an overlapping scope to a mutually exclusive area of application. In the former case, the BIT will typically be silent on any tax-measures or will not refer specifically to any parallel DTT in force between the Parties. In the latter instance, the BIT will not cover taxation either by virtue of an explicit hierarchy of sources placing the DTT higher than the BIT itself or by means of an express taxation carve-out provision.

That being said, in both instances, investment arbitration tribunals have found that where tax-measures have expropriatory effects, the provisions of the BIT can still find application, regardless of whether the relevant BIT and DTT were simultaneously applicable or not.

Relationship Between BITs and EU law

Even though externally, the EU is entering into international investment agreements with Non-Member States, after having gained this competence under the Treaty of Lisbon, 2007; internally, the EU is a firm opponent of BITs concluded between its Member States (intra-EU BITs), and especially of its dispute resolution mechanism, *viz.* arbitration. As manifested by the Court of Justice of the European Union (CJEU) in its preliminary ruling on *Achmea* on 6 March 2018, intra-EU investment arbitrations may undermine the full effectiveness of the autonomy of EU law, guaranteed by Articles 267 and 344 of the TFEU. Thus, the arbitration agreements contained in intra-EU BITs are now to be considered inapplicable. The threat of a non-uniform application of EU law stems from the fact that an arbitral tribunal constituted pursuant to an intra-EU BIT is not integrated within the judicial system of the EU. Accordingly, such a tribunal cannot refer the case to the CJEU by way of a preliminary ruling to ask for an interpretation of any EU law provision, should the dispute relate to EU law.

On 15 January 2019, several EU Member States have echoed the CJEU's stance in a joint declaration, affirming the primacy of EU law over intra-EU BITs, the invalidity of the underlying arbitration agreements contained in those instruments, and the lack of jurisdiction of any tribunal established pursuant to those agreements.

Relationship Between DTTs and EU law

To maintain that the EU Institutions are doing everything in their power to prevent intra-EU BITs and related investment arbitrations would be as correct as affirming that EU Institutions are doing everything in their power to promote intra-EU DTTs (each EU Member State has a bilateral DTT with each EU Member State) and the related tax arbitrations.

Since 1976, the Commission of the European Communities ('the Commission') has been advocating for the introduction of an effective procedure to resolve double taxation disputes on transfer-pricing. Such disputes arise out of an incorrect upward recalculation by the tax-authority of one EU Member State of the profits stemming from the transaction between associated companies established in different Member States. If the tax-authority of the Member State where the other associated company is registered does not allow for the corresponding downward adjustment of the profits, then international double taxation occurs.

The Commission's effort resulted into the adoption in 1990 of the "European Arbitration Convention

on the elimination of double taxation in connection with the adjustment of profits of associated enterprises", which entered into force in 1995 and is automatically renewed every five years. The *effective procedure* the Commission came up with was that of a *mandatory arbitration* between tax-authorities upon the request of the company affected by the upward misadjustment of the transfer price. In this arbitration the affected double-taxed company can challenge the tax-measure by invoking arbitration between the tax-authorities of the two different Member States that were unable to reach an agreement on the elimination of international double taxation.

Interestingly, the European Arbitration Convention was adopted as a multilateral Convention (and not as an EU instrument), despite the Commission's initial intentions to propose the text as a Council Directive. Reportedly, the Member States preferred the form of an inter-governmental convention because of their collective hesitation to yield part of their fiscal sovereignty. Being a multilateral convention, the CJEU is not competent to interpret the European Arbitration Convention, nor supervise its procedure, and the Commission cannot commence infringement procedures before the CJEU against any Member State not applying the arbitration procedure or not complying with the decisions rendered thereunder.

On 10 October 2017, the EU Council adopted the Directive (EU) 2017/1852 on tax dispute resolution mechanisms in the European Union to improve the procedural framework of the European Arbitration Convention and expand its scope. By issuing a directive instead of amending the original text of the European Arbitration Convention, this "cunning" move has allowed the EU Commission to bring tax treaty disputes (today around 900 cases with a total value amounting to €10.5 billion) under the EU hat and competence. The dispute mechanism of choice still remains arbitration. The improved arbitration procedure will have clear and enforceable time-limits, cover all tax disputes (not just transfer-pricing) deriving from intra-EU DTTs, and count on the supporting role of Member State courts to supervise and unblock the arbitration (should a tax authority not comply with it).

Surprisingly (or not), the rationale used to justify (and praise) this dispute resolution mechanism (which will become operative as of 1 July 2019) are the same as of any treaty-based arbitration. It intends to ensure that nationals and companies may resolve disputes related to the interpretation of an international treaty (in this case a DTT) more *swiftly* and *effectively* in order to be accorded *a fair* tax *treatment* and *avoid legal uncertainty*.

EU's Inconsistent Take on Arbitration Agreements in Intra-EU BITs in Light of Intra-EU DTTs

Arbitrations under intra-EU BITs as well as intra-EU DTTs may equally relate to the interpretation of the underlying bilateral treaty and of EU law. Indeed, every single Member State legislation on taxation is pervaded by EU tax law (one need only think of the VAT Regulation).

Both arbitral tribunals constituted under intra-EU BITs and intra-EU DTTs are not part of the judicial system of the respective member states of the EU, hence, incapable of referring the case to the CJEU for a uniform interpretation of the EU law. So, why should intra-EU BIT-based arbitration agreements be considered incompatible with EU law, while intra-EU DTT-based arbitration agreements are not only enforceable, but also encouraged by the EU Commission? The rationale expounded in the Achmea judgment is applicable to intra-EU DTT-based arbitration agreements as well; hence, aren't both type of arbitrations capable of undermining the supremacy of EU law?

Taking into account the similar objectives of intra-EU BITs and intra-EU DTTs, i.e. the promotion of cross-border investments, their similar dispute resolution mechanism (viz. arbitration), and the potentially similar effects of this mechanism on the full effectiveness of EU law, the opposite stance in regards to the compatibility of arbitration agreements with EU law taken by the EU Institutions under

those two types of treaties is difficult to understand and justify.