Assessing Tax Certainty Effectiveness Under Pillar 1

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【日本語要約】
BEPS プロジェクトの成果である第 1 の柱を実施するため、多数国間条約の策定が国際的に合意されている。OECD が公表した多数国間条約の案文には、強制的かつ拘束力のある紛争予防・解決プロセスが含まれる。本稿は、WTO の多数国間紛争解決制度が崩壊する過程を辿りながら、第１の柱の税の安定性について、その有効性を事前的に評価する。WTO の紛争解決制度は、かつて『司法化』（紛争解決権限の第三者への委譲）の成功モデルと見なされていた。それを帰納的に分析することにより、1「政治」、２「規範」、３「経済性」、４「履行」の評価視点が導き出された。

１の「政治」とは、司法と立法の対立である。国際的な紛争解決プロセスにおける義務の履行は、各国の国内法に影響を及ぼす。WTO では、「上訴機関が解釈により創造した法には議会の承認なしに従うことはできない」と米国は反発している。第１の柱においても、民主主義国家において司法と立法の衝突をどのように受容するかが問われるであろう。具体的には、「審査基準」、「（仲裁人の）意見の位置付け」、「先例拘束性」が問題となる。

２の「規範」では、独立企業間原則の断片化が焦点となる。多数国間条約と３千を超える二国間租税条約が併存するため、その相互作用が独立企業間原則を変容させ、国際課税の基本原則としての役割が揺らいでしまう可能性がある。また手続面では、多国籍企業には、国内・二国間・多国間の紛争解決手続を利用するか、あるいは全く申出をしないなどの「フォーラム・ショッピング」が可能となる。その結果、同じ又は類似の争点が複数の紛争解決手続の管轄下に置かれ、相互に矛盾した決定が下される場合が生じうる。

３の「経済性」とは、紛争解決コストの増大を意味する。WTO の紛争解決制度では、プロセスが複雑になり、様々なプレイヤーが参入することでコストが増大している。第１の柱では、対象となる多国籍企業が税の安定性の枠組みにおいてイニシアティブを持つ。対照的に、パネルシステムに参加する税務当局は、人件費や翻訳費用、旅費、決定パネルの仲裁人選定などの紛争関連費用を負担することとなる。これらのコスト

は、二国間交渉の場合よりも大きくなり、財政的・専門的資源に乏しい発展途上国にとって深刻な問題である。第１の柱の対象となる多国籍企業が集中する、米国内国歳入庁にとっても大きな負担となるであろう。

４の「履行」については、第１の柱では、履行の最終段階で合意違反が生じる可能性がある。国際課税の紛争では、その合意の履行は当事者の誠意に委ねられており、不履行に対する対抗措置は存在しない。国際法上の義務を課すだけでは、不履行の問題を解決することはできないのである。

結論として、過度な司法化は、短期的には効率的に見えるかもしれないが、紛争解決制度の有効性を低下させ、その長期的な存続を危うくする。このような将来の危機を防ぐために、本稿ではソフトロー・アプローチを提案したが、その歩みは時に政治的な行き詰まりに直面し、厄介で遅く、困難なものとなるだろう。しかし、それらは、第１の柱の長期的な存続と正当性のために支払うべき代償とみなされるべきである。司法化すればするほど、それが必要とする政治的支持を超えてしまえば、多国間紛争解決をより実効性のないものにしてしまう。長期的なビジョンについて世界的な議論が必要である。

Assessing Tax Certainty Effectiveness Under Pillar 1

by Mari Takahashi

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In this article, Takahashi assesses the effectiveness of the tax certainty process under the OECD's pillar 1 by comparing it with the WTO's dispute settlement process.

The opinions expressed in this article are the author's personal views and do not necessarily reflect organizational or state positions. The author accepts responsibility for any errors or omissions.

In October 2021 the OECD/G-20 inclusive framework on base erosion and profit shifting agreed on two pillars as solutions to tax challenges arising from the digitization of the world economy.[1] Pillar 1 adapts the international income tax system to new business models by changing the profit allocation and nexus rules and eliminating unilateral measures.[2] Following the agreement, the United States issued a joint statement with France and others on a compromise on digital services taxes and related unilateral actions.[3]

To enable swift and consistent implementation of pillar 1, a multilateral convention (MLC) will be formulated to introduce a multilateral framework for all participants. The MLC will include a mandatory and binding dispute prevention and resolution process, with appropriate allowance for the jurisdictions in which an elective binding mechanism applies.[4] The crucial question is whether the dispute resolution systems for amount A will be effective in ensuring tax certainty under pillar 1. Tax certainty effectiveness must be examined because it is an essential element of pillar 1.[5]

Up to now, the OECD has been working to increase the effectiveness of tax dispute resolution through the 2007 Manual on Effective Mutual Agreement Procedures and the 2015 BEPS action 14 final report, "Making Dispute Resolution Mechanisms More Effective." In these documents, "effective" is treated like "efficient," and a jurisprudential approach has been adopted. To be precise, introducing mandatory binding arbitration is considered to make the mutual agreement procedure effective in bilateral tax treaties.[6] However, many countries (including developing countries) are opposed to introducing arbitration on the grounds of sovereignty, and it has become a significant fault line in global negotiations.[7] Nevertheless, arbitration panels will be introduced to the tax certainty process under pillar 1.

[1] OECD, "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy" (Oct. 8, 2021).

[2] OECD, "Tax Challenges Arising From Digitalization — Report on Pillar One Blueprint," at para. 6 (Oct. 2020) (hereinafter, "blueprint").

[3] U.S. Treasury Department, "Joint Statement From the United States, Austria, France, Italy, Spain, and the United Kingdom, Regarding a Compromise on a Transitional Approach to Existing Unilateral Measures During the Interim Period Before Pillar 1 Is in Effect" (Oct. 21, 2021).

[4] An elective binding dispute resolution mechanism will be available for developing countries that meet specific conditions only for issues related to amount A. OECD, *supra* note 1, at n.1.

[5] Blueprint, *supra* note 2, at para. 703.

[6] OECD model tax convention, commentary to article 25(5), at para. 64.

[7] Mandatory binding arbitration is not a minimum standard under BEPS action 14; the introduction of arbitration is optional under the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting.

This article preliminarily assesses the effectiveness of tax certainty under pillar 1. It applies analytic methods used to study the effectiveness of the WTO's dispute settlement, which was once regarded as a successful model of "judicialization" — the delegation of authority to third parties to resolve disputes. Judicialization is the most highly legalized form of international dispute settlement mechanisms.[8] The WTO experience, from its inception to the current crisis, provides lessons on judicialization at the multilateral level.

I. Tax Certainty Under Pillar 1

While the blueprint describes the tax certainty process under pillar 1 as a new framework, it does not abandon the MAP structure; its foundation is retained. This section starts with an overview of the tax certainty process under pillar 1 and compares its structure to existing MAPs.

A. Two-Panel Structure

Although agreement has been reached on pillar 1, no specific model articles on dispute settlement have been published. At present, the blueprint on the pillar 1 report, which was published by the OECD/G-20 inclusive framework in October 2020, presents a concrete framework for multilateral dispute settlement. The blueprint provides an early level of certainty to prevent amount A before tax adjustments are made.[9]

Tax certainty is divided into two segments:

- dispute prevention and resolution for amount A; and
- dispute prevention and resolution beyond amount A.[10]

Both include a two-tiered structure consisting of a review panel comprising tax authorities and a determination panel with arbitration functions. The latter brings judicialization into the disputes.

The dispute prevention and resolution mechanism for amount A prevents double taxation and includes all issues "related to amount A" (for example, transfer pricing or attribution of business profit) in a mandatory and binding manner. There are many variables under pillar 1, including profitability criteria and the scope of exclusion. A majority of the affected multinational enterprises are U.S. companies.[11]

The approach to obtaining early confirmation of amount A is voluntary for MNEs, and they have the option of requesting confirmation from the lead tax administration.[12] If the administration determines that the return or document needs further review, it organizes a review panel composed of the (ideally six to eight) tax authorities affected by the allocation of amount A. If the review panel cannot reach an agreement, a determination panel will be formed to reach a decision.

If accepted, results are binding on the MNE and all jurisdictional tax authorities affected by the calculation and allocation of the amount A, including jurisdictions that did not directly participate in the panel.[13] If the panel and the MNE disagree on the results, the MNE may withdraw its request for early certainty and rely on the national procedures of each affected jurisdiction.[14]

B. Bilateral and Multilateral MAPs

A review panel takes the form of a MAP, a traditional dispute settlement mechanism under tax treaties provided in article 25 of the OECD's model tax convention. It is a quasi-diplomatic process commencing at the taxpayer's initiative. The most familiar MAP resolves cases in which taxpayers claim to have been subjected to taxation not in accordance with the tax treaty. This type of MAP accounts for the majority of the practice, typically in cases of transfer pricing and profit attribution to a permanent establishment. Competent authorities can deal directly with each

[8] *See* Kenneth W. Abbott et al., "The Concept of Legalization," 54(3) *Int'l Org.* 401 (2000); and Robert O. Keohane, Andrew Moravcsik, and Anne-Marie Slaughter, "Legalized Dispute Resolution: Interstate and Transnational," 54(3) *Int'l Org.* 457 (2000).

[9] Blueprint, *supra* note 2, at para. 705.

[10] *Id.* at paras. 704 and 708.

[11] Michael P. Devereux and Martin Simmler, "Who Will Pay Amount A?" EconPol Policy Brief 36 (July 2021).

[12] Blueprint, *supra* note 2, at para. 727.

[13] *Id.* at para. 706.

[14] *Id.*

other rather than through the usual diplomatic channels. They may organize a joint commission as a more formal way of carrying out the MAP.[15] However, the legal nature of the joint committee is unclear (for example, which authorities are on the joint committee, the effect of its decisions, and the difference between a joint committee and an arbitration panel).[16]

Based on the confidentiality laws, the competent authorities will not make MAPs publicly available. Because of the quasi-diplomatic process, MAPs do not have precedential value. While the MAP agreement binds the competent authorities, taxpayers are not bound, and they can strategically choose remedies under domestic law.[17]

A determination panel is a judicial process similar to an arbitration panel. Arbitration decisions are binding on the competent authorities but, in general, are not binding on the taxpayer.[18] Neither the OECD model nor the U.N. model envisages the publication of arbitration results, but under the EU arbitration convention (90/436), arbitration decisions may be published if the affected parties agree.[19] Therefore, in principle, arbitral decisions have no precedential value.[20]

A multilateral MAP to resolve cases involving several states may be achieved by negotiating bilateral MAPs (the multilateral MAP is a combination of bilateral MAPs).[21] This is expected to play a vital role in the dispute prevention and resolution beyond amount A. In practice, however, the number of multilateral MAPs reached is relatively small.[22] The blueprint explains that two focus groups of the Forum on Tax Administration are improving multilateral MAPs and advance pricing agreements.[23] However, a multilateral MAP is still in the early stages of development.

II. WTO Experience

A. Overview

The WTO was established under the WTO Agreement on January 1, 1995.[24] The origin of the WTO is the 1947 General Agreement on Tariffs and Trade. The biggest shortcoming of its dispute settlement system was that important decisions had to be made by consensus among all GATT parties, facilitating members to block the establishment of panels or unfavorable conclusions from becoming binding.[25]

In the 1980s, the consensus requirement rendered the GATT dispute settlement system dysfunctional. The United States took unilateral action against what it considered violations of GATT law.[26] In response to the unilateral U.S. action, in the Uruguay Round, other GATT member governments proposed creating a new, more procedurally legal dispute settlement system. In exchange, the United States agreed to adjudicate claims on section 301 of the Trade Act of 1974 under the WTO's dispute settlement system.[27] This deal is regarded as an "unprecedented leap in [the] legalization"[28] of the international dispute settlement system.

The WTO's primary function is providing the framework for the implementation, administration, and operation of the Plurilateral Trade Agreements.[29] The 164 members account for 99.5 percent of the world's population and about 98 percent of all international trade; three quarters

[15] OECD model tax convention, article 25(4).

[16] J. Scott Wilkie, "Article 25: Mutual Agreement Procedure," in *Global Tax Treaty Commentaries* (2017).

[17] OECD model tax convention, commentary on article 25, para. 7.

[18] There are many variations on the details in the OECD model tax convention, the U.S. model, the EU directive, and the U.N. model.

[19] *See* Wilkie, *supra* note 16.

[20] OECD model tax convention, commentary on article 25, annex para. 24, samples 4.5. and 5.6.

[21] OECD model tax convention, commentary on article 25, para. 38.1. *See also* OECD, "Transfer Pricing Guidelines," 521-523 (Jan. 2022).

[22] *See*, *e.g.*, OECD, "Making Dispute Resolution More Effective — MAP Peer Review Report, Japan (Stage 2): Inclusive Framework on BEPS: Action 14," at para. 234 (2021). Japan attended a trilateral competent authority meeting and resolved one multilateral MAP case in 2017.

[23] Blueprint, *supra* note 2, at para. 793.

[24] The Marrakesh Agreement Establishing the World Trade Organization (WTO Agreement) was signed in Marrakesh, Morocco, on Apr. 15, 1994, by the countries and customs territories that participated in the multilateral trade negotiations from 1986 to 1993 (the so-called Uruguay Round).

[25] Peter van den Bossche and Denise Prevost, *Essentials of WTO Law* (2021).

[26] *Id.*

[27] WTO, Understanding on Rules and Procedures Governing the Settlement of Disputes, at article 23.1 (hereinafter, "DSU").

[28] Manfred Elsig, "Legalization in Context: The Design of the WTO's Dispute Settlement System," 19(1) *Brit. J. Pol. & Int'l Rel.* 304 (2017).

[29] Article III.1 of the WTO Agreement, *supra* note 24.

of the WTO members consider themselves to be developing countries.[30]

B. Dispute Settlement System

The WTO's dispute settlement system can be found in the WTO Dispute Settlement Understanding (DSU). The bodies involved in the dispute settlement consist of a political body, the Dispute Settlement Body (DSB), and two independent judicial bodies: ad hoc dispute settlement panels[31] and the permanent appellate body.[32] The panel and appellate body reports become binding upon adoption by the DSB, by reverse consensus,[33] meaning the DSB decisions on these matters are, for all practical purposes, made automatically.

C. Current Crisis

The WTO dispute settlement system is in crisis. Since 2017, the United States has prevented the appellate body from filling vacancies by blocking the appointment and reappointment of its members, citing criticism of the appellate body's practice and jurisprudence. This has left the appellate body paralyzed.[34] Recent panel reports have been appealed "into the void"[35] and have lost the binding effect. The U.S. government's concerns about the appellate body are summarized in the United States Trade Representative (USTR) report released in February 2020.[36] The USTR raises a wide range of issues, including technical and procedural disputes, but the core issue is overreach by the appellate body. These specific issues are examined in Section III, applying them to the tax certainty process under pillar 1.

D. WTO Dispute Settlement Effectiveness

In the early days of the WTO, analysis of the dispute settlement system concentrated on its legal features. It was thought that judicialization would make the dispute resolution system work effectively. A leading scholar, John H. Jackson, argued that dispute settlement systems could be assessed by developing jurisprudence to provide greater certainty and stability and that the WTO deserved high marks for the quality of its legal theories.[37] He also contended that binding international law obligations could and should have a significant impact on U.S. domestic jurisprudence, as it did on the jurisprudence of many other states.[38]

On the other hand, another prominent scholar, Joost Pauwelyn, has contested this traditional view, arguing for a balance between the system's legal-normative structure and its political, decision-making branch.[39] In a related context, another observer maintained that the judicialized WTO dispute settlement system was substantively and politically unsustainable because it increasingly pressured the panels and the appellate body to "create" law, raising intractable questions of democratic legitimacy.[40]

Among these, from the perspective of the conflict between the judiciary and the legislature, the study predicted that excessive legalism undermines the effectiveness of WTO dispute settlement.[41] Although advocates of judicialization criticized it,[42] as it turns out, the study explains the intrinsic reasons that caused the WTO's crisis. The following section reorganizes its methods and assesses the effectiveness of the tax certainty process under pillar 1.

[30] Bossche and Prevost, *supra* note 25. The WTO does not define "developing country," and developing country status is based mainly on self-selection by members.

[31] Typically, the panel consists of three well-qualified governmental and/or nongovernmental individuals, many of whom are diplomats or trade officials. *See* DSU, *supra* note 27, at article 8.1.

[32] The DSB appoints the appellate body members for a term of four years, renewable only once, and they hear and decide appeals in divisions of three of its members. DSU, *supra* note 27, at articles 17.1 and 17.2.

[33] DSU, *supra* note 27, at article 2.

[34] Bossche and Prevost, *supra* note 25.

[35] It means that an appeal could be made but would never be decided.

[36] USTR, Report on the Appellate Body of the World Trade Organization (Feb. 2020) (hereinafter, "USTR report").

[37] Jackson, "The Role and Effectiveness of the WTO Dispute Settlement Mechanism," in *Brookings Trade Forum* 179 (2000).

[38] Jackson, "The WTO Dispute Settlement Understanding — Misunderstandings on the Nature of Legal Obligation," 91(1) *Am. J. Int'l L.* 60 (1997).

[39] Pauwelyn, "The Transformation of World Trade," 104(1) *Mich. L. Rev.* 1 (2005).

[40] Claude E. Barfield, "Free Trade, Sovereignty, Democracy: Future of the World Trade Organization," 2(1) *Chi. J. Int'l L.* 403 (2001).

[41] Keisuke Iida, "Is WTO Dispute Settlement Effective?" 10 *Global Governance* 207 (2004).

[42] Bernhard Zangl, "Judicialization Matters! A Comparison of Dispute Settlement Under GATT and the WTO," 52(4) *Int'l Stud. Q.* 825 (2008).

III. Tax Certainty Process Under Pillar 1

This section reviews what has happened in the areas of politics, norms, economics, and implementation with the judicialization of the WTO dispute settlement system. It then examines how they arise in the pillar 1 tax certainty process.

A. Politics: Judiciary and Legislative Conflict

In the context of dispute settlement effectiveness, politics is a matter of balance between legislation and adjudication. Inevitably, multilateral treaties contain considerable ambiguity in the wording of articles and agreements. This is because treaty negotiations often involve many countries and regions. Further, treaty interpretation can be flexible under international law, and dispute resolution may require filling in the blanks.[43] For this reason, the international dispute resolution process has become crucial in resolving differences arising over legal obligations. The fulfillment of these obligations affects the domestic laws of each country.

The U.S. criticism of the WTO appellate body fundamentally questions the conflict between the judiciary and the legislature in dispute settlement. The United States argues that the appellate body has attempted to fill in "gaps" in WTO agreements by reading into the text rights or obligations to which the United States and other members never agreed.[44] The United States alleges that this so-called judicial activism is not justified under its democratic and constitutional system. The United States cannot follow rules imposed by three individuals sitting in Geneva without government consent or the approval of the U.S. Congress.[45] As its basis, the USTR held that the appellate body exceeded its mandate on three issues:

1. standard of review;
2. status of opinions; and
3. treating prior decisions as binding precedent.

These three issues could also be problematic for the tax certainty process under pillar 1 because countries will need to incorporate all necessary references to the amount A process into domestic law, including implementation of panel decisions and other procedural aspects.[46]

1. Standard of Review

One of the USTR's concerns is that the appellate body reviews panel findings by interpreting the domestic law of WTO members.[47] Under the DSU, appeals are limited to issues of law raised in the panel's report and the legal interpretations developed by the panel.[48] On this point, the appellate body has suggested that, in some cases, it may review WTO panel decisions based on a member's domestic issues of law. The USTR, however, says that the appellate body has routinely examined the panel's factual findings and has *de novo* reviewed the meaning of members' domestic laws even though WTO members have agreed that these are factual issues not subject to appellate body review.[49]

Although the blueprint does not specify the determination panel's review standards, it seems it will not adopt the *de novo* standard. Review panels will develop specific questions for consideration by a determination panel, but the panel will not reopen elements that have already been resolved and agreed upon by all affected tax authorities.[50]

However, the blueprint does not clarify the more crucial issue: what a determination panel will consider. In tax disputes, unlike in the WTO, the scope of appeals cannot be limited to the legal issues and legal interpretations presented in the panel report because the focus of tax disputes is fact-finding. A determination panel will mainly address factual issues, and it faces challenges in setting its standard of review:

1. tax disputes require highly specific fact-finding on a case-by-case basis; and
2. it is difficult to distinguish between such factual issues and legal interpretation.

[43] Iida, *supra* note 41.

[44] USTR report, *supra* note 36, at 2.

[45] *Id*. at 13.

[46] Blueprint, *supra* note 2, at para. 818.

[47] USTR report, *supra* note 36, at Part II.C.

[48] DSU, *supra* note 27, at article 17.6.

[49] USTR report, *supra* note 36, at 37.

[50] Blueprint, *supra* note 2, at para. 773.

First, the complexity of tax cases (especially transfer pricing cases) requires detailed fact-finding to apply the arm's-length principle. It is a burdensome and complicated process for both taxpayers and tax administrations to undertake the fact-finding and prepare the necessary documents. The taxpayer often controls access to the facts needed for a proper arm's-length principle analysis, but the detailed fact-finding of specific transactions must include not just the taxpayers but also comparables.[51]

Second, the distinction between fact-finding and legal interpretation may be blurred.[52] For example, in a transaction involving an intangible asset, is the choice of the method for calculating the arm's-length price a matter of fact-finding or legal interpretation? Facts and interpretations are too intricate to draw a clear line in real-world tax dispute situations. Difficulties in distinguishing between factual issues and legal interpretations have arisen in many legal systems, including the WTO, limiting appellate courts to reviewing points of law.[53]

2. Status of Opinions

The USTR claims that the WTO's appellate body has issued an advisory opinion that includes discussion unnecessary to resolving the dispute.[54] The WTO agreement text does not explicitly provide advisory opinions. The United States argues that advisory opinions are unnecessary for resolving specific disputes, exceed the appellate body's authority, and "make law" by interpretations. This is contrary to the principles of the WTO agreement.

Under pillar 1, the chair of the determination panel will prepare a summary of the conclusions, including the main reasons behind the decision, even though the determination panel will adopt a last-best-offer approach.[55] Under this approach (also known as final-offer arbitration), the arbitrator is restricted to choosing the last offer made by one of the parties. The effect of this approach under pillar 1 is unclear.

Nevertheless, a dispute on amount A could affect many countries, including those that have not participated in detailed discussions — those that have not joined the review panel or challenged the review panel's recommendations.[56]

3. Prior Decisions as Binding Precedent

The USTR challenges the precedential nature of the rulings.[57] It argues that the appellate body requires panels to follow previous rulings, adding or reducing WTO members' rights and obligations through clarifying ambiguous provisions.

In early cases, the appellate body was restrained in recognizing the precedential value of its rulings.[58] In *Japan — Taxes on Alcoholic Beverages II* (WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, 1996), the appellate body held that with regard to earlier GATT panel reports, "they create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute."[59] The appellate body also suggested that its interpretation of the WTO agreement was not definitive and would not bind WTO members except in specific disputes.

Nevertheless, in *U.S. — Final Anti-Dumping Measures on Stainless Steel From Mexico* (WT/DS344/AB/R, 2008), the appellate body held that the security and predictability contemplated by the DSU[60] require that the adjudicating body resolve the same issues in the same manner in subsequent cases in the absence of "cogent reasons" to deviate from earlier decisions.[61] In light of this decision, the application of a provision is relevant only to the case in which it is made, while clarifications contained in adopted panels or appellate body reports are relevant beyond the specific dispute. Since then, several WTO panel rulings have relied on previous

[51] Joseph L. Andrus and Richard S. Collier, "Transfer Pricing and the Arm's-Length Principle After the Pillars," *Tax Notes Int'l*, Jan. 31, 2022, p. 543.

[52] *See* Congressional Research Service, "The World Trade Organization's (WTO's) Appellate Body: Key Disputes and Controversies," R46852, at 13 (July 22, 2021) (hereinafter, "CRS").

[53] *Id*.

[54] USTR report, *supra* note 36, at Part II.D.

[55] Blueprint, *supra* note 2, at para. 774.

[56] *Id*. at para. 771.

[57] USTR report, *supra* note 36, at Part II.E.

[58] CRS, *supra* note 52, at 20.

[59] Bossche and Prevost, *supra* note 25.

[60] DSU, *supra* note 27, at article 3.2.

[61] Bossche and Prevost, *supra* note 25. *See also* CRS, *supra* note 52.

appellate body decisions. But the USTR argues that the appellate body cannot require panels to treat its decisions as precedent.

Under pillar 1, whether determination panel precedent should be binding is not clearly stated, but it seems to require "consistency" of panel decisions for later determination panels. It says:

> Work will be undertaken to develop a control framework for the determination panel, setting out specific rules for the determination of the Chair and panel members, and procedures for undertaking a review and reaching decisions. *This may also include the development of guidance as needed, supported by the secretariat, to promote consistency in the decisions of later determination panels considering similar issues. . . .* This should facilitate reviews being completed more quickly and reduce the need for questions to be referred to a determination panel which concern issues that have been dealt with previously.[62] [Emphasis added.]

More puzzling is that the panel's conclusion still binds tax authorities, even after the MNE withdraws its request for tax certainty. According to the blueprint, the rationale is to remove the risk of double taxation and prevent future disputes by consistent implementation of the panel's findings.[63]

B. Norms: Arm's-Length Principle Fragmentation

If judicialization unifies the dispute resolution process through compulsory jurisdiction and thereby ensures binding precedent, it may accumulate substantive norms and assure the integrity of the law. In international law, however, the proliferation of international dispute settlement organizations has led to fragmentation. Each specialized court or tribunal makes unique and significant judgments on general international law, undermining the coherence of the international legal system.[64]

At the WTO, fragmentation has arisen mainly in procedural conflicts with regional trade agreements (RTAs),[65] the number of which has been increasing rapidly in recent years.[66] Many RTA procedures are characterized as quasi-judicial procedures similar to those of the WTO. Meanwhile, RTA substantive rules overlap considerably with the laws of the WTO agreement. A single dispute could be subject to the jurisdiction and rules of both the WTO and the RTA, resulting in conflicting or inconsistent rulings in each forum.

Under the pillar 1 tax certainty process, fragmentation of norms is inevitable because more than 3,000 bilateral tax treaties[67] would remain in force and continue to govern cross-border taxation outside amount A. The pillar 1 MLC must coexist with the existing tax treaty network,[68] raising the question of overlapping substantial rules and procedures.

First, on the substantive side, it is critical to pillar 1 that the arm's-length principle function properly because all issues "relating to amount A" involve transfer pricing issues. In bilateral treaties, the arm's-length principle, which is provided in article 9 of the OECD's model tax convention, requires companies to engage in arm's-length transactions. The new agreement does not abolish the arm's-length principle but supplements and modifies its application for the world's largest corporations. In other words, the formulary override will supplement the allocation system based on the arm's-length

[62] Blueprint, *supra* note 2, at para. 776.

[63] *Id.* at para. 779.

[64] *See* Anne Peters, "The Refinement of International Law: From Fragmentation to Regime Interaction and Politicization," 15(3) *Int'l J. Const. L.* 671 (2017). The International Law Commission addressed this issue in 2000, and a series of research groups issued interim reports that were finalized by Martti Koskenniemi in 2006.

[65] Tsuyoshi Kawase, "Competition and Coordination in Dispute Settlement Procedures Between WTO and Regional Economic Communities: Comparative Review of Forum-Choice Clauses (Japanese)," RIETI Discussion Paper (2007).

[66] The total number of RTAs reported to the WTO as of the end of January 2022 is 353. *See* WTO, "Regional Trade Agreements" (last accessed Feb. 24, 2022).

[67] OECD, "Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting," at 1 (2017).

[68] Blueprint, *supra* note 2, at para. 828.

principle for a small number of large, highly profitable companies.[69] In contrast, the arm's-length principle of the bilateral treaty will continue to apply to all companies and virtually all income. This difference in treatment could alter the operation of the arm's-length principle and raise doubts about its viability as a basis for global taxation.[70] A similar problem will arise in the domestic laws of the pillar 1 participating countries.

Second, on the procedure side, tax dispute settlement jurisdiction is neither mandatory nor exclusive in both MAPs and the tax certainty under pillar 1. MNEs may take advantage of forum shopping: domestically, bilaterally, multilaterally, or with no request at all. Consequently, the same disputed fact may be subject to the jurisdiction of multiple dispute resolution procedures in some cases, resulting in mutually inconsistent decisions.

C. Economics: Increasing Costs

Highly judicialized dispute resolution may reduce the cost-effectiveness and incentives for the parties involved. Although there are a wide variety of economic theories on the functioning of the international system, the essence lies in the expected payoff for the participants. Parties are more likely to participate in the system if their expectations of future benefits exceed the costs. If not, they would prefer not to participate in the system. In a situation in which the expected gain is uncertain, parties would decide whether to participate in dispute resolution, relying on the costs that could be incurred.

In the WTO dispute settlement system, the process has become technically complex, increasing legal costs. The judicialization has made the interests of the private sector more critical and increased the role of private lawyers.[71] The WTO dispute resolution system involves not only states but also private party interests.[72] Larger private companies tend to organize, hire lawyers, and use the WTO dispute settlement system more aggressively. Moreover, their interests are often inconsistent with those of the countries that actually negotiate, giving rise to politics over how to argue and defend claims.[73] With this background, in *U.S. — Large Civil Aircraft*, involving subsidies given to Boeing and Airbus, it was estimated that fees ran at $1 million per month, and the dispute continued for 17 years.[74]

Increasing costs are a problem for developing countries looking to access the WTO dispute settlement system. Small governments often do not have sufficient internal expertise to handle the complex cases before the WTO dispute settlement system. It requires legal fees and a significant time commitment from officials whose governments may already be severely under-resourced.[75] For them, the Advisory Centre for WTO Law, an independent international organization based in Geneva, provides legal advice on WTO law. However, there is a global political divide on funding it.[76]

The MNEs covered by pillar 1, many of which exceed the economic size of small countries, take the initiative to obtain tax certainty. In contrast, tax authorities participating in the two panels vary in size but will bear the costs associated with the disputes, including personnel, translation, travel costs for the two panels, and arbitrators at the determination panel. These costs will be higher than they would be in a bilateral negotiation. However, if MNEs make strategic withdrawals during the process or disagree on implementation, the cost incurred by tax authorities may be wasted.

[69] Andrus and Collier, *supra* note 51.

[70] *Id.*

[71] Gregory Shaffer, Manfred Elsig, and Sergio Puig, "Chapter 10: The Law and Politics of WTO Dispute Settlement," in *The Politics of International Law* 269 (2016).

[72] At the WTO, only the member states have access to the WTO dispute settlement system; however, in practice, members bring almost all disputes at the initiative of affected industries and companies. *See* Bossche and Prevost, *supra* note 25.

[73] Shaffer, *supra* note 71.

[74] *Id. See also* European Commission and USTR, Understanding on a Cooperative Framework for Large Civil Aircraft (June 15, 2021).

[75] Hakan Nordstrom and Shaffer, "Access to Justice in the World Trade Organization: A Case for a Small Claims Procedure?" 7(4) *World Trade Rev.* 587 (2008).

[76] *Id.*

These are serious problems for developing countries with limited financial and professional resources. They want assurance that tax disputes will result in satisfactory outcomes. One solution is to provide a designated legal aid fund. However, regarding the Advisory Centre for WTO Law, this may not be politically feasible.

Resources are an issue not only for developing countries but also for the IRS. In many cases under pillar 1, it must control the operation of the two panels as the lead tax administration. While recognizing the risk of exceeding the authorities' capacity, the blueprint does not pay much attention to resources to help multinational groups achieve certainty.[77] To address this resource issue, the blueprint offers the option of imposing a condition limiting question submission to a determination panel for a definitive outcome if the MNE group agrees to be bound by the panel's decision,[78] but it is doubtful that option will work.

D. Implementation: Remaining Incompleteness

At the WTO, if the respondent has failed to implement the recommendations and rulings of the DSB correctly within a reasonable period, the DSU provides for two temporary remedies: compensation and retaliation.[79] Despite this, in about 20 percent of the disputes, the respondents do not comply with the ruling.[80] A high degree of legalization, such as in the WTO, has not facilitated the implementation of all decisions. In other words, even if international law obligations are imposed for compliance, incompleteness remains. While there has been much research on non-implementation in the WTO, a prominent study discusses the (in)efficient breach of international obligations from the economic theory of contract remedies.[81]

In international tax disputes, implementation is left to the parties' good faith, and there is no countermeasure for noncompliance. Under pillar 1, a legal obligation may be imposed on competent authorities to implement decisions through an MLC to achieve binding results.[82] Nevertheless, an efficient breach of the agreement may occur in the final stages of implementation depending on the economic situation of the parties. Merely imposing obligations under international law will not solve the problem of non-implementation.

IV. Proposal

A. Look Before Leaping

In the literature on international regimes, analysis has focused on establishing and developing judicialization within international institutions for sustaining cooperation over time.[83] From this perspective, some papers call for the institutionalization of tax arbitration and the organization of a central institution for tax certainty under pillar 1.[84]

However, it is highly doubtful that pillar 1 will achieve further international political consensus to endorse judicialization and institutionalization of dispute settlement. It would be impractical to establish an international dispute resolution body for pillar 1. In founding such an institutional body, it would be necessary to consider the benefits and costs (including the institutional budget[85]). Most importantly, there must be an international political consensus to support it.

B. Clarification of Objective and Method

As a first step in the system's design, it is necessary to clarify what tax certainty under pillar 1 is intended to achieve. If the focus is on resolving specific disputes, judicial proceedings may not always be necessary, but a forum with a

[77] Blueprint, *supra* note 2, at para. 745.

[78] *Id.* at paras. 770 and 775.

[79] DSU, *supra* note 27, at article 22.

[80] Bossche and Prevost, *supra* note 25.

[81] Warren F. Schwartz and Alan O. Sykes, "The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization," 31(1) *J. Legal Stud.* S179 (2002).

[82] Blueprint, *supra* note 2, at para. 802.

[83] *See, e.g.*, Andreas Hasenclever, Peter Mayer, and Volker Rittberger, *Theories of International Regimes* (1997).

[84] *See, e.g.*, Spyridon E. Malamis and Qiang Cai, "International Tax Dispute Resolution in Light of Pillar One: New Challenges and Opportunities," 75(2) *Bull. Int'l Tax'n* 94 (Feb. 2021).

[85] The WTO's total budget for 2021 was CHF 195 million. The amount of contribution depends on each member's share of world trade, and the top three contributors to the WTO budget in 2021 are EU members (30.45 percent), the United States (11.7 percent), and China (10.4 percent). For members with less than a 0.015 percent share of international trade, a minimum contribution of 0.015 percent to the WTO budget is required. WTO, "WTO Secretariat Budget for 2021" (last accessed Feb. 24, 2022).

diplomatic negotiation among the parties may be more conducive to the parties' reasonable satisfaction. On the other hand, if the role of dispute resolution is to ensure uniformity and integrity of rules (leaving aside the question of whether it can be achieved), judicialization may be necessary. It will also determine the standard of review — for example, how much deference a determination panel gives to a review panel.

Another possible approach is to narrow the leeway for legal discretion through final-offer arbitration. The final-offer approach reduces the need for extensive fact-finding and legal interpretation. It is cost-effective to resolve specific disputes because all tax disputes ultimately result in the amount of tax to be paid. The role of the chair in a determination panel under the final-offer method should be carefully examined.

C. Soft-Law Enforcement and Transparency

Some observers argue that the crisis of the WTO has been caused by overreliance on the hard-law, hard-enforcement approach, which adopts binding rules and enforces them through binding dispute settlement procedures. These observers call for more active use of a soft-law, soft-enforcement method.[86]

The soft-law approach with peer review should be strengthened in international taxation, in line with the 2015 final report on BEPS action 14. The primary function of the peer review process is to motivate parties to comply with the rules voluntarily. In an international community without a centralized enforcement body, effective voluntary compliance by sovereign states is essential.

For the further development of peer review, it may be necessary to increase the transparency of dispute resolution. However, as repeatedly stated, tax cases are highly individualized, and they should not always be disclosed, considering the complexity of the case and the relationship with the taxpayer or the other states. More research is needed on this issue.

V. Conclusion

The collapse of the WTO dispute settlement system shows the consequences of judicialization in the multilateral system. The effectiveness of dispute resolution is essential for compliance and enforcement of the system; however, overformal judicialization may reduce effectiveness and jeopardize the system's long-term viability. The soft-law approach, proposed to prevent this future crisis, will sometimes face political deadlock, and its progress will be messy, slow, and challenging. However, such "lethargy"[87] should be seen as a price to pay for the long-term survival and legitimacy of pillar 1.

Excessive judicialization may appear efficient in the short term but inherently erodes the effectiveness of the dispute resolution system. More judicialization, if going beyond the political support it requires, makes multilateral dispute resolution less effective. There needs to be a global discussion about a long-term vision. ■

[86] Yuka Fukunaga, "The Soft-Law, Soft-Enforcement Approach Is Key to Reinvigorating the WTO," AJISS-Commentary No. 265 (Mar. 4, 2019). *See also* Mary E. Footer, "The (Re)Turn to 'Soft Law' in Reconciling the Antinomies in WTO Law," 11(2) *Melbourne J. Int'l L.* 241 (2010).

[87] *See* Pauwelyn, *supra* note 39.