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Utilizing Baseball Arbitration for Transfer Pricing Tax Disputes in Canada: Current Trends and Future Perspectives

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Abstract

While baseball arbitration has been recognized as a method for settling international tax disagreements, this paper concentrates on one of the most debated issues in tax treaty conflicts: transfer pricing. Emphasizing transfer pricing in cross-border tax disputes highlights its increasing importance and significant consequences for both tax authorities and corporate taxpayers. The study explores the possible use of baseball arbitration to resolve transfer pricing disagreements in Canada, referencing best practices from the United States, the OECD, and the United Nations tax treaty models. Results suggest that the traditional baseball arbitration model may not be appropriate for all transfer pricing cases, especially those with major policy implications. To overcome this challenge, the paper proposes a modified version called "Baseball Arbitration Plus" (BAP), which involves a three-step process. This new approach could greatly influence tax policy, especially regarding the interpretation of existing tax treaties.

Key words: Transfer Pricing , Baseball Arbitration , Dispute Resolution , Tax Disputes

Introduction

The recent years have witnessed significant interest in effective tax dispute settlement with the increasing importance of tax treaty arbitration. From several analysis involving base erosion and profit sharing (BEPS), it has been argued that the post-BEPS world will witness an uptick in tax treaty disputes due to the numerous measures being taken to tackle the menace of treaty abuse (Neto 2019, 2–16). While the Organisation for Economic Co-operation and Development (OECD) and the European Union have taken commendable initiatives to enhance the dispute resolution mechanisms in tax matters,[1] it thus appears that baseball arbitration, which is also known as final offer arbitration (FOA) (Pauwelyn 2019), is becoming one of the trendiest mechanisms for alternative dispute resolution. One would then wonder whether this new and innovative dispute resolution mechanism could help to resolve disputes involving transfer pricing tax disputes which is becoming the most prevalent tax dispute in North America with significance implications for the rest of the world.

To provide a context to the ensuing discussion, it is pertinent to note that despite the numerous efforts of the OECD, United Nations and other international and regional bodies to enhance tax certainty, there has been an increasing trend in new tax disputes between government authorities and multinational corporations (MNCs). According to the latest available statistics released by the OECD, in 2019, an uptick of over 20% was recorded as compared to 2018 where taxpayers resorted to the Mutual Agreement Procedures (MAP) in the relevant tax treaties to resolve their transfer pricing disputes (Martin 2019). This trend, although not encouraging, is expected to continue to skyrocket in the coming years if bold policy reforms are not introduced to stem the rising tide (Li, Cockfield, and Wilkie 2018, 436).

The overarching principle underpinning tax treaty disputes is that contracting states could come up with their unique method of resolving international tax disputes (M. A. Markham 2019, 473–504). However, the uniqueness of the concept of tax treaty baseball arbitration presents a significant opportunity for contracting states to explore such method due to its inherent features (Tulis 2010), which includes its mandatory nature, enforceability, secrecy and transparency of the procedure, and the participation of taxpayer. Given the policy implication and reactionary responses of tax authorities in matters involving transfer pricing and

[1] See the amended Article 25 of the *OECD Model on the Mutual Agreement Procedure* and the EU's Council Directive 2017/1852 on tax dispute resolution mechanisms in the European Union.

treaty interpretation, one would expect tax authorities to push for major reforms that would allow the courts to refer transfer pricing tax disputes to arbitration, with specific directions to use baseball arbitration.

At present, the mechanisms available in Canada to prevent and/or resolve transfer pricing disputes include rulings; the use of Advanced Pricing Agreements (APA) which could be unilateral, bilateral or even multilateral APAs; MAP; objections to assessments pursuant to Section 165 of the Income Tax Act where taxpayers could appeal transfer pricing adjustments to the dedicated Appeal Division of the Canadian Revenue Agency (CRA) for an independent impartial review, and ultimately, the court (Sandler and Watzinger 2019a). Nevertheless, to address the unique nature of transfer pricing tax disputes, this paper examines the potential of baseball arbitration with some modifications through what it calls the "Baseball Arbitration Plus" or BAP model for transfer pricing disputes, which includes a three-part process for tax dispute resolution. This model could be included in future amendments to tax treaties between Canada and other jurisdictions to ensure proper streamlining of the process in situations where the competent authorities are unable to reach a settlement of a double taxation issue.

This paper seeks to establish that baseball arbitration should not just be loosely introduced as an effective means for resolving transfer pricing tax disputes in Canada, but there should be relevant law reforms to institutionalise this form of arbitration with some major modifications where the courts will be mandated to refer parties to such arbitration if they deem it necessary for the overall interest of not only the taxpayers but also for the tax authority in Canada. To argue this thesis, the paper is organized as follows: Part II provides an overview of previous studies in baseball arbitration and further zooms in into limited studies on the use of baseball arbitration for transfer pricing disputes. Part III examines current trends in transfer pricing dispute management mechanism in Canada where it addresses both the dispute avoidance and dispute resolution mechanisms. Part IV explores to what extent is baseball arbitration a more effective mechanism for transfer pricing disputes. It considers the specific features of baseball arbitration and proposes the "BAP model for transfer pricing disputes. Finally, Part V provides the conclusion where the study reaffirms the need for a new approach in transfer pricing dispute resolution through the institutionalization of BAP process.

Literature Review

This study attempts to examine the potential of utilising baseball arbitration for transfer pricing tax disputes within the context of tax treaties with reference to Canada. In doing so, the study relied upon both primary and secondary sources, in addition to tertiary sources that were mostly utilised during the exploratory exercise to identify the current trends as well as potential future directions. The primary sources relied upon include the *Canadian Income Tax Act* ("ITA"), the United States-Canada Tax Treaty, 2017 OECD Model Tax Convention (OECD 2017), the relevant United Nations Guides on MAP,[2] the EU Arbitration Convention and other relevant commentaries and reports. While some references are made to some notable U.S. cases, the study primarily focuses on the complexities involved in Canadian case law relating to transfer pricing and treaty interpretation. On the other hand, this study also relies on secondary sources such as books, journal articles and relevant research reports on baseball arbitration, transfer pricing disputes and MAP with a view to synthesising the relevant material considering the primary sources to be able to identify to research gaps for potential recommendations. The major themes identified in this study, which this brief literature review will explore, are transfer pricing dispute resolution, baseball arbitration, and prospects of mandatory dispute resolution.

First, there have been numerous studies conducted on transfer pricing dispute resolution based on the OECD tax treaty framework. Michelle Markham attempted to address the possibility of utilizing arbitration

[2] To date, there are three Guides issued by the United Nations, and they are: *Note on Dispute Resolution: Guide to Mutual Service Agreement Procedure* (E/C.18/2011/CRP.4) 11 October 2011, *Guide to the Mutual Agreement Procedure under Tax Treaties* (E/C.18/2010/CRP.2/Add.1) 8 October 2010, and *Guide to the Mutual Agreement Procedure under Tax Treaties* as agreed by the Committee of Experts in their annual meeting in 2012.

for the increasing number of tax treaty disputes (M. A. Markham 2019), which generally includes transfer pricing disputes. While considering impeding factors such as sovereignty, the study provides a good basis for the further exploration of new methods such as baseball arbitration. In addition, Michelle Markham explores the need to explore arbitration for transfer pricing disputes in one of the notable papers on the subject matter (Markham 2005). In the wake of the OECD's BEPS Action Plan, there is definitely an urgent need to identify the most advantageous tax treat dispute resolution mechanism for both the governments and the MNCs in particular amidst various mechanisms such as MAP, arbitration, APA or even baseball arbitration (Markham 2019).

Second, there are emerging studies on the relevance of baseball arbitration to cross-border tax disputes generally. Foremost among such studies is L. Neto's analysis of the relevance of baseball arbitration to international tax disputes (Neto 2019). This reinforces the relevance of tax treaty baseball arbitration in accordance with widely adopted approaches. It is also helpful to anticipate potential issues in utilizing the approach which will provide some insight into how to address such issues before they arise (Neto 2019). In more comparative study, Raffaele Petruzzi, Petra Koch and Laura Turcan attempt to compare baseball arbitration with other types of arbitration in the field of tax law with reference to double tax treaties (DTTs). A relevant part of the work compares baseball arbitration under the OECD and the UN conventional arbitration. Its conclusion may have some implications for the current study, as it concludes that a ""magic formula" for a perfect arbitration procedure, applicable in all different situations, might not (and most probably would not) exist. However, by implementing some of the features of the other, each of the two existing types of arbitration employed in tax law disputes could reach more efficient and effective results." (Petruzzi, Koch, and Turcan 2024, 156). This could support the argument of this study that suggests embedding mediation within the baseball arbitration procedure for disputes relating to DTTs "when carefully calibrated", as qualified by Pauwelyn J. in a separate analysis of the concept (Pauwelyn 2019, 40). While Pauwelyn (2019) argued that an optimal dispute resolution mechanism might be more appropriate for disputes relating to DTTs, what such approach entails remains illusory to different experts. For Pauwelyn, an optimal dispute resolution mechanism should ordinarily be a combination of "reasoned arbitration (on threshold issues) and FOA (on numerical questions)." (Pauwelyn 2019).

While the above approach holds some water as it goes beyond just the traditional baseball arbitration, this study will argue that a "Baseball Arbitration Plus" approach might be more appropriate which will triangulate binding mediation, reasoned arbitration, and FOA. With this approach, which will be described later in this study, parties will be directly involved in the decision-making process since party autonomy is sacrosanct not only in contractual matters but also in the dispute resolution process. The approach to be proposed in this study will introduce an additional step in the FOA procedure that would allow for mediation based on threshold issues before the final offer is presented by each of the disputing parties. In essence, rather than conferring the powers on the arbitrator to choose between two offers, parties are empowered to consider a compromise proposed by the arbitrator at a preliminary stage. Such approach would change the very nature of baseball arbitration in disputes involving DTTs and present what could be referred to as a win-win situation for the parties (Sussman and Gleason 2019).

Third, few studies have proposed the need for mandatory dispute resolution for transfer pricing disputes (Markham 2019b; Farah 2022). While this approach has its advantages, the procedure is important since arbitration is just one of many methods of dispute resolution. As Jeffrey Owens rightly argued, mandatory tax arbitration has a lot of potential in providing the much-needed certainty in the relationship between MNCs and tax authorities with the increasing uncertainties in the global political and economic environment (Owens 2018). However, as argued by Yariv Brauner, mandatory arbitration in cross-border tax disputes should be reformed so that it will win the confidence of developing economies who are often sceptical of tax treaty arbitration (Báez Moreno 2020). This justifies the hypothesis of this study that the proposed reforms are not only for tax treaty arbitration but there is still some further scope to reform baseball arbitration to address the unique nature of transfer pricing disputes in DTTs.

Despite the numerous studies identified above, it seems there is still a gap relating to the need to institutionalize baseball arbitration for transfer pricing disputes globally, and in Canada in particular. While a number of previous studies have referred to arbitration under the United States-Canada Convention and the effect of MAP (Mulvihill, O'Riordan, and Wrappe 2011; Burnett 2007; Mulvihill and Wrappe 2011; Monsenego 2014; Kollmann et al. 2015), there has not been a major study on the relevance of baseball arbitration or even a modified version of it for Canadian tax legal framework. Hence, this study is expected to fill the research gap by proposing a modified baseball arbitration model for disputes involving DTTs in Canada where it is proposed that the tax court or even the appellate court should be statutorily empowered to refer complex disputes relating to transfer pricing to what will be referred to as "Mandatory Baseball Arbitration Plus" – a new approach which modifies the commonly known baseball arbitration.

Current Trends in Transfer Pricing Dispute Management in Canada

Given the nature of cross-border tax disputes involving treaty interpretations, it is pertinent to briefly examine current trends in transfer pricing dispute resolution. This is expected to provide a good basis for any proposal that will be made at the end of this study. The question to be examined here is: how are transfer disputes currently being resolved in Canada? In answering this question, one would consider the effect of unintended economic consequences of transfer pricing disputes. In a situation where a transfer price is not accepted in the jurisdictions involved in a dispute, there could be the undesirable outcome of double taxation, which will lead to economic inefficiency and pose significant threat to international trade (Markham 2005).

In most cases, transfer pricing disputes are often associated with numerical questions; hence, they are more amenable to baseball arbitration. However, there are some marginal cases where threshold issues are engaged; and such issues, there is always the need for a reasoned decision. Taking a clue from the OECD, the underlying principle for transfer pricing in Canada is the arm's length principle, which was adopted to govern tax treatment cross-border transactions involving related parties (MacPherson et al. 2014). In Part XVI.1 of the ITA, subsection 247(2) confers on the CRA the authority to enforce the arm's length principle on related taxpayers (Li, Cockfield, and Wilkie 2018, 105–16). In the administration of the transfer pricing rules, there are bound to be differing views which ultimately result in disputes.[3] For instance, the deeming rule in section 247(4) of the ITA may be subject to different interpretation as to what constitute "reasonable efforts" in determining and using "arm's-length prices or allocations" (Li, Cockfield, and Wilkie 2018).

The transfer pricing dispute management mechanisms available in Canada can be classified into dispute avoidance processes on one hand and the dispute resolution processes on the other hand. Such characterization is essential for a better understanding of the current trends in transfer pricing dispute management, which also takes into consideration administrative approaches to avoiding and resolving such disputes. Though while a more extended discussion of each of the processes is precluded by space limitations, this section provides a brief overview of each of them before having a deep dive into the potentials and limitations of baseball arbitration in the next section. However, due to the nature of MAP and the arbitration process introduced in the OECD Tax Convention, a rather detailed analysis on MAP and arbitration is provided here.

Dispute Avoidance Processes:

Tax Rulings

Rulings are considered as a dispute avoidance process within the general spectrum of dispute management processes for transfer pricing disputes. The tax rulings help to prevent disputes, as they provide sufficient clarity for taxpayers which helps to ensure voluntary compliance and avoid any controversy between the CRA and the taxpayer. In Canada, the Income Tax Rulings Directorate within the CRA is saddled with the responsibility of issuing advance income tax rulings as well as technical interpretations which are often relied upon by taxpayers. The tax rulings are mainly interpretations of the ITA, Income Tax Regulations

[3] On the discretionary powers of the Minister, particularly on issues relating to downward transfer pricing adjustments, see *TeleTech Canada, Inc. v. Canada (National Revenue)* (2013 FC 572).

and other applicable statutes, which may include tax treaties. Even though there is no specific legal requirement to issue rulings, they are principally meant "to promote voluntary compliance, uniformity and self-assessment by providing certainty with respect to the application of Canadian income tax law to proposed transactions." (CRA 2021, para. 12). Further to Canada's commitment with respect to exchange of information on rulings under BEPS Action 5, Canada would provide spontaneous exchange of information on every tax ruling with some countries. Amongst others, one important type of rulings for exchange of information is required under the BEPS project is cross-border rulings related to transfer pricing legislation. There are however two exceptions to the continuous application of a ruling: first, a legislation may supersede a ruling after amendments are made, and in such circumstances, the ruling will cease to bind the CRA (OECD 2015, para. 16). Second, a ruling could be overridden by a subsequent court decision but that will only apply to transactions that occur after the court's decision (OECD 2015, para. 17).

Advance Pricing Agreements (APA)

In anticipation of potential disputes or differences in the interpretation of transfer pricing arrangements, the Advance Pricing Agreements or Advance Pricing Arrangements (APA) are often used to prevent future tax disputes (Markham 2013). This potent tool is often used by taxpayers, particularly MNCs to ensure enhanced certainty in issues relating to their transfer pricing policies to ensure that they comply with the ITA, relevant CRA guidance and OECD. The Competent Authority Services Division[4] of CRA administers the APA. While APA has been used in several transactions by taxpayers in determining the appropriate transfer pricing methodologies (TPMs), particularly for non-arm's length transactions with non-resident entities, this could be unilateral, bilateral or even multilateral APAs (Li, Cockfield, and Wilkie 2018, 138–39). In 2020, Canada successfully completed 15 APAs where only 2 were unilateral and the vast majority of 13 were bilateral agreements with foreign tax administrators (CRA 2020).

Dispute Resolution Processes

Mutual Agreement Procedure

The Mutual Agreements Procedure or MAP is one of the major dispute settlement mechanisms recommended by the OECD. Article 25 of the OECD Model Tax Convention prescribes this unique method where regardless of other remedies provided for in domestic law, any taxpayer who is of the view that the actions of one or two contracting states would lead to a taxation treatment that is contrary to the provisions of the Convention, can present its case to competent authority of any of the contracting state. In the event that the issue is not resolved unilaterally by one of the contracting states, such state is under an obligation under the relevant treaty to endeavour to resolve the dispute with the other state through the MAP mechanism (M. Markham 2018, 280). In addition, Article 25(1) of the Convention also includes a proviso which sets a limitation period of three years for such action.

A MAP article is often included in Conventions where designated government representatives (otherwise referred to as "the competent authorities") from the contracting states are authorised to interact with one another with the sole objective of resolving international tax disputes (M. Markham 2018, 139). Such disputes usually involve some inconsistencies in the interpretation and application of relevant convention and cases of double taxation (Ault 2005). The MAP mechanism helps to ensure clarity on matters involving the taxation of an entity or individual (OECD, n.d., 8). Though the MAP mechanism is not binding nor mandatory, it however helps to encourage cross-border economic activities by preventing double taxation (Li, Cockfield, and Wilkie 2018, 436).

Article 25(6) of the Convention specifically provides for arbitration for unresolved issues that may arise from the MAP process provided the taxpayer requests this in writing. This was meant to address an

[4] The Competent Authority Services Division is part of the International and Large Business Directorate of the Compliance Programs branch of CRA.

unintended challenge posed by the MAP process where most of the cases presented to competent authorities were not resolved within time (Nowland 2014). Such protracted cases and the limited participation of the taxpayers in the entire MAP process might have resulted to the subsequent reforms by the OECD, which borrowed a leaf from the EU Arbitration Convention.[5] This led to the introduction of a mandatory and binding arbitration mechanism subsequent to the MAP process or in situations where MAP has failed. While arbitration has its advantages, it appears some of the ills of litigation are now being experienced in arbitration, and these include legal complexities, costs, and protractedness (Rashid 2008; Katz 2008). Even though the US-Canada tax treaty has the mandatory arbitration clause[6], including "in respect of an unresolved competent authority request which originated with, or in conjunction with, a bilateral Advance Pricing Agreement/Arrangement (APA) request" (CRA 2010), the complexities involved in arbitration, limited tax arbitration experts, and the inconsistencies in the relevant arbitration standards have negatively impacted the choice of arbitration as a preferred tax dispute resolution mechanism (Li, Cockfield, and Wilkie 2018, 436).

The binding arbitration was introduced through the Fifth Protocol to the Canada-US Income Tax Convention in 2007. On top of that, the downside of the unique procedure established by the US-Canada Arbitration Board Operating Guidelines is that the final decision of the mandatory arbitration procedure is a final number without any additional comment or reasoning behind such a decision (Petruzzi, Koch, and Turcan 2024, 142).

In the EU, there was an initial move to establish a permanent arbitration tribunal for international tax disputes, but the proposal did not see the light of the day; and the European Court of Justice (ECJ) was designated as the arbitral tribunal pursuant to Article 273 of the Treaty on the Functioning of the European Union and in accordance with the relevant double tax treaties between the contracting states in a case (Stadler 2017). This therefore calls for a search of an alternative process which will not only be cost-effective but also fast and seamless.

Re-Assessment Appeal: Transfer Pricing Adjustment

In an objection to assessment pursuant to Section 165 of ITA, the taxpayer could appeal transfer pricing adjustments to the dedicated Appeal Division of the CRA for an independent impartial review. Large corporations could make their objections to assessment under subsection 165(1.11) of the ITA. Once the Minister receives such a notice of objection, the Minister shall "reconsider the assessment and vacate, confirm or vary the assessment or reassess, and shall thereupon notify the taxpayer in writing of the Minister's action".[7] Pursuant to subsection 165(7) of the ITA, if a MNC is dissatisfied with the reassessment, there is no requirement to serve a notice of objection to the reassessment before appealing the decision to the Tax Court of Canada (TCC) (Sandler and Watzinger 2019b).

Courts

As discussed above, the TCC has jurisdiction to hear appeals relating to reassessment or additional assessment pursuant to Section 167(7) of the ITA, which shall be in accordance with section 169 of the ITA. So, if a taxpayer is dissatisfied with a transfer pricing tax adjustment, it may bring such an appeal to the TCC for the court to either vacate or vary the assessment. Under Section 169(1)(b), if the taxpayer serves a notice of objection and the Minister fails to take any action, such taxpayer will be able to proceed

[5] See Mutual Agreement and Arbitration Procedure in Section 3 of the Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises (90/463EEC) ["EU Arbitration Convention"].

[6] Apart from the US-Canada Memorandum, the two countries also concluded the Arbitration Board Operating Guidelines which streamlines the arbitration process with clear procedures that are targeted at having an expeditious process. The process is like the fast-track arbitration process which is often based on documentation – a similar feature in baseball arbitration. For more details on the US-Canada Arbitration Board Operating Guidelines (Mulvihill, O'Riordan, and Wrappe 2011).

[7] See Section 165(3) of the ITA.

with the appeal at the TCC after 90 days.[8] Further to Section 171(4), an appeal from the TCC lies at the Federal Court of Appeal in accordance with the provisions of the *Tax Court of Canada Act*[9] and the *Federal Courts Act*[10]. Appeals from the Federal Court of Appeal lies to the Supreme Court of Canada.

Having reviewed the dispute management processes for tax disputes, particular transfer pricing cases, one would conclude that the complexities involved in transfer pricing dispute resolution may stifle cross-border economic activities. In addition, there is the concern that some judges, particularly the apex court may not be favourable disposed to tax appeals; hence, the Supreme Court of Canada in *Canada v. Addison & Leyen Ltd.*,[11] reaffirmed "Tax Court's exclusive jurisdiction" which it feels "does not present an issue of public importance requiring the intervention of the Supreme Court." (Jacyk 2012, 72). The Supreme Court of Canada emphasized:

The integrity and efficacy of the system of tax assessments and appeals should be preserved. Parliament has set up a complex structure to deal with a multitude of tax-related claims, and this structure relies on an independent and specialized court, the Tax Court of Canada. Judicial review should not be used to develop a new form of incidental litigation designed to circumvent the system of tax appeals established by Parliament and the jurisdiction of the Tax Court. Judicial review should remain a remedy of last resort in this context.[12]

This accounts for the rejection of the leave to appeal many tax-related cases emanating from the Federal Court of Appeal. Relying on the reasoning of the apex court, one would therefore conclude that uniform tax jurisprudence is that of deference to the TCC[13]; hence, there is a need for a more efficient process which will not just be party-driven but also cost-effective and consensus-building with a view to promote cross-border economic activities.

Baseball Arbitration: A More Effective Procedure for Transfer Pricing Disputes?

As a quick fix for transfer pricing disputes, there has been increasing call from some tax experts to utilize baseball arbitration or FOA. This section of the study provides an overview of a typical baseball arbitration and how it can be utilized for transfer pricing dispute resolution. It also provides a proposal on "Baseball Arbitration Plus" which this study considers as a modified baseball arbitration procedure that would not only fulfil the interest of the disputing parties but also have some future implications on tax policy. Given the limited space, this section will not discuss baseball arbitration in any great depth; instead, a general overview is provided to give a high-level background to the discussion that follows with respect to the proposal for "Baseball Arbitration Plus".

Potentials of Baseball Arbitration in Tax Treaties

The reason why baseball arbitration is also called pendulum arbitration is because the arbitrator is empowered to choose between one of the parties' proposals and that becomes the final decision. Other common names used in describing baseball arbitration include "high-low arbitration" (Petruzzi, Koch, and Turcan 2024, 138), "one-or-the other", "either-or", "flip-flop", "last-best-offer", and "straight offer" (Chetwynd 2009, 110). It is important to begin with the origin of this unique form of arbitration. Baseball

[8] See *Topol v. Canada (Minister of National Revenue - M.N.R.)*, [2003] F.C.J. No. 858. In para 23, Per Layden-Stevenson J. emphasized that: "A taxpayer may file an objection to an assessment within 90 days after the day of mailing the notice of assessment. If the assessment is confirmed, the taxpayer may appeal further to the Tax Court. If the objection is not dealt with within 90 days, a taxpayer may choose to appeal directly to the Tax Court rather than wait for a ruling on the objection (subsection 169(1))".
[9] R.S.C., 1985, c. T-2.
[10] R.S.C., 1985, c. F-7.
[11] [2007] S.C.J. No. 33.
[12] Ibid.
[13] See the landmark treaty decision of the Court of Appeal in *The Queen v. Prévost Car Inc.* [2009] F.C.J. No. 241, where the court affirmed the interpretation of "beneficial ownership" in Article 10(2) of the *Convention Between Canada and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, S.C. 1986, c. 48, Schedule 1, as amended.

arbitration traces its origin to salary disputes between players and team owners in major league baseball sector in the United States (Petruzzi, Koch, and Turcan 2024, 138). The main trigger was the dominance and the complete control of team owners when it comes to salary of the players, and this was done through "reserve clauses" in the employment contracts. As a result, the Major League Baseball Players Association (MLBPA) was established in 1954 by the players which unionized their relationships with the owners of the teams. This subsequently led to the adoption of salary arbitration in 1973 in a landmark agreement between the MLBPA and the owners (Petruzzi, Koch, and Turcan 2024, 138). The agreement was made further to a proposal from the owners to salvage the reserve system, which remains largely in effect till today (Tulis 2010, 85).

In the baseball arbitration of the US major league baseball, either of the parties could request for arbitration. The relevant team and the player submit their individual numbers relating to the proposed salary to an arbitrator, followed by a hearing where both parties make their representation before the arbitrator, and finally, the arbitrator chooses one of the two numbers which becomes the salary of the player for the new season. Such decision is final and binding on the parties. One unique advantage of the proceeding is the strict deadlines provided; hence, the process is a fast-tracked procedure. Table 1 summarizes the distinguishing features of baseball arbitration compared to the traditional arbitration. Typically, an arbitrator is expected to issue its decision within 24 hours of concluding the hearing without any written opinion (Monhait 2013). It is however important to emphasize that parties could continue their negotiations after the commencement of the arbitration proceedings (Petruzzi, Koch, and Turcan 2024, 138).

Table 1: Baseball Arbitration versus Traditional Arbitration

	Feature	Traditional Arbitration	Baseball Arbitration
1.	Arbitrators' Authority	Broad	Highly Restrictive
2.	Decision	Well-reasoned Written Award	Mathematical Settlement
3.	Process Timing	Broad	Narrow
4.	Precedents	Generally Available	Not Available
5.	Criteria for Decision	Generally Broad	Highly Restrictive

Source: Author

Just as the baseball arbitration was introduced into the realm of tax treaties by the United States,[14] the country also took the lead in utilizing arbitration as a tax dispute resolution mechanism. The preference of the US for mandatory arbitration for tax treaty disputes in the event that the competent authorities in the contracting states are not able to reach a settlement of a double taxation issue in the US-Germany DTT in 2006 was one of the major factors that led to the introduction of arbitration clause for similar issues in the OECD Model Tax Convention in 2008. Consequently, "the OECD acknowledged that competent authorities have the option to use the final offer approach instead of the independent opinion approach provided for in the *Sample Mutual Agreement on Arbitration.*" (Petruzzi, Koch, and Turcan 2024, 140). This singular development ushered in a new era where competent authorities could use baseball arbitration for cross-border tax treaty disputes.

Future Perspectives: A Proposal for "Baseball Arbitration Plus"

This study seeks to triangulate between the baseball arbitration format, arbitration under the OECD and UN Models, and efficient tax policy considerations. The proposed BAP draws some lessons from Dickinson's (2004) "combined arbitration", Pauwelyn's (2019, 40) "optimal dispute resolution" and the need to render policy decisions on certain transfer pricing disputes as precedents for future cases. If handled properly in

[14] Binding arbitration was introduced through the Fifth Protocol to the Canada-US Income Tax Convention in 2007.

developed jurisdictions, the OECD could develop a central repository for such policy decisions, which will guide future global tax reforms.

As illustrated in Table 2 below, the proposed BAP is divided into three major phases. Phase 1 provides for some preliminary processes such as Early Neutral Evaluation (ENE) and Conciliation. This phase only kicks in when competent authorities in the contracting states are unable to reach a settlement of a double taxation issue. It is however important to consider appointing an independent tax expert, preferably from a third country to conduct a preliminary evaluation of the differing positions of both competent authorities and render his or her opinion within a definitive timeline, preferably within 7 days of receiving the necessary information. The opinion, if not accepted by both parties, will be referred to conciliation where a decision will be made within 7 days. Subsequently, if either of the contracting states is still dissatisfied with the decision of the conciliator, such a party would have a maximum of 15 days to refer the dispute to arbitration.

Therefore, Phase 2 which is primarily the arbitration phase, comprises three different aspects: *final offer arbitration, fair arbitration, and reasoned arbitration.* First, just like the typical baseball arbitration, if one of the offers is a fair settlement, the arbitrator could render the decision within 3 days of the hearing without a written award. Second, the fair arbitration option is only relevant when the fair settlement of the arbitrator as contained in his or her award lies outside the final offers presented by the parties. In such situation, the arbitrator is required to provide a brief written award providing the reasons for its position. Third, the reasoned arbitration should only be used in cases that involve treaty interpretation which could potentially have some significant policy implications. For the reasoned arbitration, the award should be rendered within 15 days of the conclusion of hearing.

The final phase, Phase 3, is dedicated for transfer pricing cases that have significant policy implications which require precedents. If in the opinion of the tax authority a reasoned arbitration culminates into an award with significant policy implication, it could file an application in a competent court for a declaratory judgment which is not appealable, as it would only serve as a policy decision. The *Tax Court of Canada Act* could also be amended to allow for the referral of an appeal made to it under the ITA by a taxpayer to the BAP process. In the event of such referral, any policy decision rendered in Phase 2 of the proposed BAP process should be referred to the TCC for adoption as a declaratory judgment.

Table 2: Proposed "Baseball Arbitration Plus"

Phase	Process	Third-Party Decision Maker	Remarks	Timeline
Phase 1				
Preliminaries	Early Neutral Evaluation (ENE)	Independent Tax Expert	Referral to ENE if competent authorities are unable to agree	Process to be completed within 7 days
	Conciliation	Tax Conciliator	A decision is made at this stage but either party could still refer matter to arbitration	Process to be completed within 7 days. Referral to arbitration to be made within 15 days
Phase 2				
Arbitration	Final offer arbitration	Arbitrator	If one of the offers is fair settlement without reasons	Decision to be rendered within 3 days of hearing

Phase	Process	Third-Party Decision Maker	Remarks	Timeline
	Fair Arbitration	Arbitrator	If fair settlement lies outside the final offers but with reasons	Decision to be rendered within 5 days of hearing
	Reasoned Arbitration	Arbitrator	If tax treaty dispute has significant policy implications	Decision to be rendered within 15 days of hearing
Phase 3				
Court	Application for leave to file a Policy Decision	Tax court judge	Tax authority to file the application in the competent court only for tax treaty disputes with policy implications	Within 30 days of reasoned arbitral award

Source: Author

To what extent is the new proposal on BAP applicable to a recent Canadian case relating to benefits under tax treaties? A review of the complex issues involving interpretation of a tax treaty between Canada and Luxembourg and extant Canadian general anti-avoidance rule (GAAR) raised during the hearing of the appeal in *Canada v. Alta Energy Luxembourg SARL*[15] reaffirms the hypothesis of this study on the need to explore more effective dispute resolution mechanism for cross-border tax disputes.[16] Simply put the case involves the extent of application of GAAR and this boils down to the interpretation of the exemption under the applicable treaty. This is an issue that transcends mere mathematical settlement, and it thus has some policy implications, which accounts for the reason why the Supreme Court of Canada earlier granted the application for leave to appeal from the Federal Court of Appeal. Depending on where the pendulum swings, a policy decision from the apex court will help clarify the sticking points and prevent any actual "abuse" or "misuse" under the GAAR.

While it is given that the traditional arbitration may not handle such a case better, the typical baseball arbitration would neither do better. Therefore, to ensure policy decisions are handled properly, the steps identified for the BAP procedure could be explored. As earlier highlighted, the BAP procedure contemplates a situation where an appellate court refers a case such as the *Alta Energy* to such appropriate BAP procedure to save the limited court time. The BAP arbitrators are not mere general arbitrators or judges, but senior jurists.[17] A final BAP decision could be affirmed by the appellate court upon application by either party without the need to go through a full hearing. With such a process, the BAP decision with far reaching policy implication could be transformed to a binding court decision, thereby relating judicial precedents for future cases coming before the TCC.

Conclusion

Cross-border tax disputes, particularly those relating to transfer pricing and treaty interpretation, have been at the core of what could be regarded as "international taxation". For any efficient process of tax dispute resolution, some key features to be considered include certainty, predictability, flexibility, substantial

[15] Supreme Court of Canada (Case Number: 39113).

[16] In *Canada v. Alta Energy Luxembourg SARL* (2020 FCA 43; which affirmed 2018 TCC 152), the Federal Court of Appeal upheld the decision of the Tax Court of Canada which held that GAAR did not apply to a sale of taxable Canadian property by a Luxembourg entity. Both courts relied on the immovable property exemption in the Canada-Luxembourg tax treaty.

[17] These senior tax jurists may comprise retired judges of TCC or even appellate courts who throughout their careers specialized in tax cases. They also include senior tax lawyers as well as senior tax academics who are chosen from a panel of tax arbitrators.

parties' involvement, cost-efficiency, and time-effectiveness. While there are key processes of dispute management as enshrined in the OECD and UN Models, arbitration and litigation seem to be the most used processes. In Canada, though there are some preliminary dispute avoidance processes which are statutorily enforced under the ITA, tax litigation seems to be the preferred method for transfer pricing disputes as evidenced in the available case law. The complexities involved in transfer pricing cases, particularly those that require tax treaty interpretation have confounded tax litigation in Canada, and this is seen in some of the appeals that find their ways up to the Supreme Court of Canada.

Beyond litigation, this study has identified other tax dispute management processes within the context of transfer pricing disputes in Canada. While drawing significant ideas from existing literature and the OECD and UN Models, this study analyses baseball arbitration and finds that such mechanism, although largely efficient when it comes to the determination of the quantum of tax liability, may not be appropriate for policy decisions involving treaty interpretation. Therefore, this study proposed the BAP which also draws some ideas from existing proposals from Dickinson (2004) and Pauwelyn (2019) with substantial modifications with a view to establishing a more efficient transfer pricing dispute resolution mechanism in Canada. Of course, such proposal could be considered in future amendments to the OECD and UN Models with a view to exploring the possibility of global adoption of the simplified model of BAP. Future research could consider a pilot project utilizing BAP for transfer pricing disputes in real-time. This could be spearheaded by the CRA, as such pilot project would be a good launching pad for the internationalization of the model.

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