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The Latin American Opposition to Mandatory Arbitration in Tax Treaties: Origins, the Calvo Doctrine, and a Reappraisal

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The Latin American Opposition to Mandatory Arbitration in Tax Treaties: Origins, the Calvo Doctrine, and a Reappraisal

by

*Yariv Brauner**

Abstract

The international tax regime has recently made large strides toward a reform of its dispute resolution mechanism. Long-anticipated, mandatory tax treaty arbitration is finally gaining legitimacy beyond limited use by a few countries. Yet, the opposition to international arbitration among developing countries, led by Latin American countries, has not waned. This Article tracks this opposition to its origins and argues that it is misguided in the case of tax treaty arbitration, which such countries should rather generally support.

Introduction 867
I. The Calvo Doctrine 870
II. Latin America and International Arbitration of Economic Matters 873
III. Latin American States' Opposition to Mandatory Tax Treaty Arbitration 877
Conclusion: Arbitration Is Not the Problem 881

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Introduction

The past few years have been volatile for the international tax regime.[1] Its importance and growth have not waned, yet it has experienced multiple "shocks," which may help reformulate and strengthen the regime or threaten its existence. Geopolitical changes, particularly the ascent of China, India, and other developing countries,[2] naturally challenged the formerly OECD-dominated regime.[3]

Globalization processes exposed the problematic norms used by the regime despite a lack of strong intellectual basis or wide international support for at least some of these norms.[4] Similarly, such processes diminished the ability of states to effectively enforce their tax rules, especially vis-à-vis the largest Multinational Enterprises (MNE), a state of affairs painfully exposed by the global financial crisis when most states, rich and poor, found themselves aching for revenue and finally united to try and tackle the problem in what became the Base Erosion

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1. Reuven S. Avi-Yonah, *Commentary*, 53 Tax L. Rev. 167, 169 (2000) (explaining that the international tax regime is constructed around the network of bilateral tax treaties, essentially all of which are modeled after the OECD Model Tax Convention). The original acknowledgment of the existence of such a regime was in Reuven S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 Tex. L. Rev. 1301, 1349 (1996).

2. This has been especially reflected in the growing importance of the G20 organization, which includes the world's largest economies, developed and developing. *See, e.g.*, Isaac Kwaku Fokuo & Akinyi Ochieng, *Move Over G7. The Future Belongs to a More Inclusive G20*, World Econ. F. (June 25, 2018), https://www.weforum.org/agenda/2018/06/move-over-g7-future-belongs-more-inclusive-g20/; *The G20: Its Role and Legacy*, Russ. G20 http://en.g20russia.ru/docs/about/part_G20.html (last visited June 25, 2020).

3. BRICS and the Emergence of International Tax Coordination (Yariv Brauner & Pasquale Pistone eds., 2015).

4. Most notably the weak solution to the challenges presented by the taxation of electronic commerce and derivative financial instruments, the ongoing debate over the transfer pricing rules and their effectiveness, and the protest against the trend of reducing source taxation in favor of taxation at residence, all of which have been exposed by the BEPS project. *See* OECD, *Addressing Base Erosion and Profit Shifting* (2013), http://www.oecd.org/tax/addressing-base-erosion-and-profit-shifting-9789264192744-en.htm.

and Profit Shifting (BEPS) project.[5] The political nature of the BEPS project, its accomplishments and shortcomings have been extensively exposed elsewhere,[6] yet one crucial aspect of the international tax regime—its dispute resolution mechanism—has attracted less attention, perhaps due to the relative lack of progress achieved in its regard in BEPS.[7]

To date the international tax regime has relied on a relatively "soft" dispute resolution procedure—the mutual agreement procedure (MAP).[8] The softness of this procedure may have been its strength since it seemed to pose little threat to the sovereignty of states and hence perhaps could have been tolerated better than other, more formal procedures, yet it also seemed unsatisfactory, particularly to taxpayers that were unable to benefit from a timely resolution of their complaints under the MAP.[9] The growing volume of disputes, which promises only to increase post-BEPS, exacerbates the pressure to reform and better formalize treaty dispute resolution.[10]

5. *See id.*; *see also* OECD, *Action Plan on Base Erosion and Profit Shifting* (2013), https://www.oecd.org/ctp/BEPSActionPlan.pdf; *International Collaboration to End Tax Avoidance*, OECD, http://www.oecd.org/ctp/beps (last visited June 25, 2020) (describing the BEPS Project).

6. *See, e.g.*, 2017 IFA Conference, *Assessing BEPS: Origins, Standards, and Responses*, 102A Cahiers de Droit Fiscal Int'l (2017); Yariv Brauner, *Treaties in the Aftermath of BEPS*, 41 Brook. J. Int'l L. 973 (2016); Yariv Brauner, *What the BEPS*?, 16 Fla. Tax Rev. 55 (2014); Reuven S. Avi-Yonah & Haiyan Xu, *Evaluating BEPS*, 10 Erasmus L. Rev. 3 (2017).

7. OECD, *Making Dispute Resolution Mechanisms More Effective, Action 14—2015 Final Report* (2015), https://doi.org/10.1787/9789264241633-en.

8. Article 25 in both the OECD and U.N. Model tax conventions. OECD, Model Tax Convention on Income and on Capital: Condensed Version 2017, art. 25 (2017), https://doi.org/10.1787/mtc_cond-2017-en; U.N., Model Double Taxation Convention Between Developed and Developing Countries, art. 25 (2017), https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf; *see also Dispute Resolution*, OECD, https://www.oecd.org/tax/dispute/ (last visited June 25, 2020) (listing page on dispute resolution).

9. *See, e.g.*, Robert A. Green, *Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes*, 23 Yale J. Int'l L. 79 (1998).

10. *See, e.g.*, Todd Welty et al., *Preparing for a Tsunami of International Tax Disputes*, 80 Tax Notes Int'l 1047 (Dec. 21, 2015).

Such pressure is not new, and the OECD itself, years prior to BEPS, studied the matter and recommended, albeit without universal support, to include mandatory arbitration clauses in tax treaties to supplement the MAPs when they stall.[11] Non-mandatory arbitration clauses had been attempted prior to such recommendation yet had been ineffective.[12] The recommended clauses were picked up by few states and have had only minor impact pre-BEPS. During the BEPS project, some states, notably led by the United States, had attempted to include universal mandatory arbitration in tax treaties but failed to do so.[13] In a sort of a compromise, the Multilateral Instrument (MLI) included a special, voluntary part, to which states could opt in.[14] Thirty states (not including the United States, but which should be counted as a proponent) opted in to instantly amend their treaties with an inclusion of the proposed mandatory arbitration clause. These countries are, however, notably traditional OECD members, lacking meaningful participation of developing countries.[15]

The opposition of developing countries to mandatory tax treaty arbitration is well known and longstanding, and Latin American states

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11. *See* OECD, *Improving the Resolution of Tax Treaty Disputes* (2007), http://www.oecd.org/ctp/dispute/38055311.pdf.

12. Mostly fashioned after the U.N. Commentary on Article 25, paragraph 14, although similarly not prohibited of course by the OECD Commentary.

13. With a few exceptions, such as the U.S. treaties with Germany, Belgium, Canada, and France. *See Mandatory Arbitration with Germany, Belgium, Canada, and France*, IRS, https://www.irs.gov/businesses/international-businesses/mandatory-arbitration-with-germany-belgium-and-canada (last updated Oct. 28, 2019).

14. OECD, Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, pt. VI (2016), https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf.

15. The states include Andorra, Australia, Austria, Barbados, Belgium, Canada, Curacao, Denmark, Fiji, Finland, France, Germany, Greece, Ireland, Italy, Japan, Liechtenstein, Luxembourg, Malta, Mauritius, the Netherlands, New Zealand, Papua - New Guinea, Portugal, Singapore, Slovenia, Spain, Sweden, Switzerland, and the United Kingdom. *Signatories and Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, OECD, www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf (last updated June 27, 2020) [hereinafter *MLI Signatories and Parties*].

have prominently featured in this opposition.[16] This Article tracks such opposition to the more general suspicion of arbitration in Latin America, which has its origins in the famous "Calvo Doctrine" of the 19th century, and the development of the same ideas to the present. This Article then evaluates the current validity of this suspicion and its likely impact on the states of the region.

I. The Calvo Doctrine

Simply put, the Calvo doctrine asserts that sovereign states enjoy freedom from interference of any sort, including interference by foreign states trying to protect their own citizens and the investments of such citizens in the sovereign states. Correspondingly, the states where such investments take place have a responsibility for such (welcomed) foreign investment, yet, and this is the crux of the matter, according to the Calvo doctrine, the responsibility of a government for foreigners cannot be greater than its responsibility for its own citizens.[17] Clearly, this doctrine is based on a very strong view of the sovereignty, freedom, and independence of states, a view that has not been universally accepted, not surprisingly resulting in a lack of universal adoption of the Calvo doctrine itself.[18]

The Calvo doctrine is best understood against the historical and political background leading to it. Post-colonialist Latin American states[19] found themselves in a conflict that plagued the rest of the developing world. They wished to assert their independence and sovereignty and at the same time keep being attractive to foreign investment from

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16. *See, e.g.*, Betty Andrade Rodríguez, *Implementation v. Adaptation: BEPS in Latin America Through the Lens of the ILADT Model*, 9 World Tax J., no. 3, 2017; Natalia Quiñones Cruz, *International Tax Arbitration and the Sovereignty Objection: The South American Perspective*, 73 Tax Notes Int'l 533 (Aug. 11, 2008); Luís Eduardo Schoueri & Mateus Calicchio Barbosa, *Brazil—MAP Guidance Released by the Revenue Service*, 24 Int'l Transfer Pricing J., no. 4, 2017.

17. Donald R. Shea, The Calvo Clause: A Problem of Inter-American and International Law and Diplomacy 19 (1955) (relying on Calvo's treatise: Carlos Calvo, Le Droit International Théorique et Pratique (1896)).

18. *Id.*

19. Whether actually colonized or strongly impacted or even exploited by forceful foreign investment, especially in the natural resources industries.

countries that insisted on protecting their citizens' investments in Latin America based on their own standards, which they deemed superior to the standards of protection in the developing host countries. Extraterritorial privileges were initially accepted in many parts of the world, often decimated and eventually abolished later in the 20th century. They have, however, faced much more resistance in Latin America.

Alternatively, the institution of diplomatic protection was developed to allow foreign investors to appeal for protection by their governments when remedy had not been available through the institutions of the host states.[20] Often, diplomatic protection was supported by the view that an injury to a citizen of a state is an injury to the state itself. The political turmoil and unsteadiness in some Latin American states indeed resulted in some such injuries and the inability to rectify them through domestic judicial channels, triggering diplomatic protection moves. Intervention took the format of diplomatic negotiations, political pressures, arbitration, and even the use of force.[21] Often, however, claims arose that diplomatic protection was abused by foreign investors and their (Western) states, especially when armed intervention was used against the weaker states in what seemed to the latter as new colonialization based on diplomatic protection excuses. Diplomatic protection as a balancing act was therefore viewed with suspicion in Latin America where the sensitivity to threats against sovereignty had been particularly important. The question became: what are the boundaries of lawful intervention under international law?

The debate first focused on prior agreements, prohibiting the use of force for the collection of public debt, agreements that included exceptions that were subject to differing interpretations and in any event had been too narrow, not establishing the boundaries for diplomatic protection of foreign investors.[22] Such prohibition was known as the Drago doctrine, named after an Argentinian foreign minister, Dr. Luis Drago, yet its limited scope could not support the needs of Latin American countries facing abuses based on diplomatic protection.[23]

The answer came with the writings of another Argentinian, Carlos Calvo, a diplomat, publicist, and scholar, who articulated his

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20. *See* Frederick S. Dunn, The Protection of Nationals: A Study in the Application of International Law (1932).

21. *See, e.g.*, Shea, *supra* note 17, at 11.

22. *See, e.g.*, *id.* at 14–16.

23. *Id.*

doctrine in a series of writings in the second part of the 19th century.[24] Nonetheless, despite attempts of Latin American countries to argue for the doctrine, it has never been accepted as part of international law by other countries,[25] and attempts by various countries to apply the doctrine by including it in one version or another in treaties have largely failed.[26]

This failure had not reduced the enthusiasm of Latin America for the doctrine, and some countries have since tried to insert it into their constitutions, laws, and other legal means, all of which have proven not to work. The overall threat to sovereignty presented by diplomatic protection (especially that of military intervention) had slowly been lowered in the beginning of the 20th century, and at the same time the institutions of Latin American countries improved, reducing the corresponding threat to foreign investors, yet these developments have not changed the overall perception of Latin American countries that, following their failures to promote the Calvo doctrine, began promoting so-called Calvo clauses in treaties.[27]

Calvo clauses come in many variations, yet their basic idea is to significantly limit, by agreement between the investor and the host state, the threat of foreign intervention in domestic protection of foreign investors in Latin American countries, making such intervention a true last resort. Overall, such clauses have had limited success in preventing contrary actions by the foreign investors, yet not actions by the home states.[28] The home states argued based on the principle that a harm to a citizen is a harm to her state that the individual investor could not prevent her state from making a claim for its injury, an argument that was generally accepted outside Latin America and by various international courts and arbitration panels where it had been made.[29] Validity of such clauses meant that in most cases investors could not seek remedy outside the institutions of the host state since they had conceded that only such institutions would have jurisdiction in these cases.[30] The question

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24. *Id.* at 17.
25. *Id.* at 20.
26. *Id.* at 24.
27. *See, e.g.*, Gerhard von Glahn, Law Among Nations: An Introduction to Public International Law 249 (4th ed. 1981).
28. *Id.* at 234, 249.
29. *Id.*
30. *See, e.g.*, Shea, *supra* note 17, at 254–55.

of the validity of Calvo clauses (and of the Calvo doctrine as a matter of fact) is tangentially affected by the much larger issue of the status of individuals under international law since, as this status strengthens, the power of the clauses becomes more significant.[31]

II. Latin America and International Arbitration of Economic Matters

The transformation of the Calvo doctrine into Calvo clauses, which eventually permit diplomatic protection, but only as a last resort, in one form or another has coincided with global political and economic changes that made the business environment in Latin American countries generally less threatening and the resort to domestic legal systems less risky for foreign investors, and, at the same time, reduced the threat of foreign intervention, especially armed interventions, in Latin American affairs by Western powers. Calvo clauses have proliferated in this environment in treaties involving Latin American countries with various consequences. Much scholarship has analyzed the impact of such clauses, debating their reflection of international law, yet as a matter of practice they have not gone away and to some extent became acceptable and applicable in a large number of cases based on treaties that include them.[32] Yet, it is similarly clear that so-called Calvo clauses have not become the standard in international economic relationships, especially not in the context of investment. The use of such clauses, and the continuous belief in the validity of the Calvo doctrine more generally, could not stop the ascent of arbitration to dominance as the primary, and standard, device to resolve international investment disputes.

Arbitration as a dispute settlement device goes back at least to King Solomon and has been used over the years in various formats,[33] yet on the international economic scene it has become dominant only since the last century. This trend began with the establishment of the Permanent Court of Arbitration in the Hague in 1899,[34] followed by the

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31. This much larger issue is, however, beyond the scope of this Essay.

32. *See, e.g.*, Shea, *supra* note 17.

33. *See, e.g.*, Frank D. Emerson, *History of Arbitration Practice and Law*, 19 Clev. St. L. Rev. 155 (1970).

34. All American states are party to one or both of its constitutive treaties. *See Permanent Court of Arbitration*, PCA–CPA.org, https://pca-cpa.org/en/about/introduction/ contracting-parties/ (last visited June 26, 2020).

formal commitment of the League of Nations to arbitration, including the establishment of the Permanent Court of International Justice, both of which started at a low pace, leaving most of the developments prior to WWII to domestic and regional initiatives.

Twentieth century investment law consistently focused on the use of arbitration to improve its efficacy.[35] Various now dominant institutions that facilitate international investment arbitration were established,[36] as well as standard rules and procedures for the conduct of the arbitration procedures[37] and conventions ensuring their enforcement.[38] Similar procedures were developed in trade matters, leading of course to the supranational dispute resolution procedures embedded in the World Trade Organization (WTO).[39] Both of these dispute resolution systems are now under serious criticism and pressure to reform,[40] but it

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35. *See, e.g.*, Christoph H. Schreuer et al., The ICSID Convention: A Commentary (2d ed. 2009); Kenneth J. Vandevelde, *Bilateral Investment Treaties: History, Policy and Interpretation* (Thomas Jefferson Sch. of Law Research Paper No. 3022249, 2010), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3022249.

36. Such as the World Bank's International Center for Settlement of Investment Disputes (ICSID), established in 1966. ICSID, https://icsid.worldbank.org/en/ (last visited July 14, 2020); *see also* Arb. Inst. Stockholm Chamber Com. (SCC), https://sccinstitute.com/; Int'l Chamber Com. (ICC), https://iccwbo.org/dispute-resolution-services/icc-international-court-arbitration/ (last visited July 14, 2020); London Ct. Int'l Arb. (LCIA), https://www.lcia.org/ (last visited July 14, 2020); *Permanent Court of Arbitration*, *supra* note 34.

37. Most notably the U.N. Commission on International Trade Law's (UNCITRAL) rules. *See United Nations Commission on International Trade Law*, U.N., http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration.html (last visited June 26, 2020).

38. Most notably the U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, June 10, 1958), known as the "New York Convention." See its dedicated website: NewYorkConvention.org, http://www.newyorkconvention.org/English (last visited June 26, 2020).

39. *See Dispute Settlement*, WTO, https://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm (last visited June 26, 2020).

40. A comprehension review of this pressure is beyond the scope of this Article, and there is a tremendously vast scholarship covering it. However, for the current state of affairs, see, for example, The Backlash Against Investment Arbitration: Perceptions and Reality (Michael Waibel et al. eds., 2010); Phillippe Fouchard, *Suggestions to Improve the International*

would be a mistake to expect such pressure to lead to a distancing of countries from arbitration and perhaps reverting to diplomatic agreements or other, less cooperative procedures because the pressure is not to eliminate arbitration, but rather it is applied for the purpose of improving arbitration and making it more effective and fair. Consequently, there is no case for the opposition to mandatory tax treaty arbitration to support such stance based on the turmoil in the investment and trade dispute resolution mechanisms.

The primary forum for the most controversial type of disputes, known as the investor-state investment disputes under bilateral investment treaties (BIT), is ICSID.[41] At the present most American states are members of ICSID (Belize signed the treaty in 1986 yet never ratified it), with the notable exception of Brazil (as well as Cuba and Surinam). Most of them joined the treaty in the late 1980s or early 1990s. Bolivia, Ecuador, and Venezuela were members only to withdraw from the treaty in 2007. Even the latter countries continued, however, to be engaged in investment arbitration procedure after their withdrawal from ICSID based on BITs with several countries, using UNCITRAL, ICSID (additional facility rules), and ICC rules, typically under the Permanent Court of Arbitration. Essentially all of the region's countries adopted the New York Convention and its Latin American version, known as the Panama Convention, which perhaps eased these countries into the international investment arbitration system.[42]

Arbitration fared even better in private law, where commercial arbitration became the primary mechanism for dispute resolution.[43] In this context as well, developing countries led by Latin American countries have been very critical of the dominant institutions. Also similar

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Efficacy of Arbitral Awards, *in* Improving the Efficiency of Arbitration Agreements and Awards: 40 Years of Application of the New York Convention 601 (Albert Jan van den Berg ed., 1999); Daniel Barstow Magraw Jr. & Niranjali Manel Amerasinghe, *Transparency and Participation in Investor-State Arbitration*, 15 ILSA J. Int'l & Comp. L. 337 (2009).

41. *See supra* note 36.

42. The 1975 Inter-American Convention on International Commercial Arbitration. *See, e.g.*, Albert Jan van den Berg, *The New York Convention 1958 and Panama Convention 1975: Redundancy or Compatibility*?, 5 Arb. Int'l 214 (1989).

43. *See, e.g.*, Nigel Blackaby et al., Redfern and Hunter on International Arbitration (6th ed. 2015); Gary B. Born, International Commercial Arbitration (2d ed. 2014).

to the processes mentioned above, such criticism diminished over the years as such countries succumbed to the universal trend and even became very active in arbitration procedures[44]—diminished but not disappeared. The arguments of developing countries relied on their belief that there is both an institutional and a doctrinal bias in favor of developed countries in the system of international commercial arbitration.[45]

Attempting to reconcile their desire to be part of the international economic system and their cautious attitude toward Western dominated procedures, Latin American countries have nevertheless slowly amended their domestic laws and even domestic institutions to ensure compatibility with accepted international norms, including an increasing trend of conducting arbitrations within the region.[46] Yet, the laws of some countries in the region have not yet sufficiently insulated arbitration procedures from domestic judicial intervention, and in fact the region still faces more such intervention than the norm in the rest of the world.[47] The traditional suspicions of arbitrations have particularly risen with the rise of claims made against Latin American countries under BITs, to the effect of various attempts to limit the power and impact of BITs and the consent to arbitration in some Latin American countries, especially those impacted most by populism.[48]

Finally, constitutional challenges of arbitration procedures continue to be part of the Latin American legal scene, in different formats, and not technically following the Calvo doctrine but perhaps in spirit still represent the caution in the region, suspicious of foreign

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44. *See, e.g.*, *2017 ICC Dispute Resolution Statistics*, ICC Dispute Resolution Bull., no. 2, 2018, at 51. The process was eased by the adoption of the Panama Convention. *See supra* note 42 and accompanying text.

45. R. Rajesh Babu, *International Commercial Arbitration and the Developing Countries*, AALCO Q. Bull., no. 4, 2006, at 385.

46. *See, e.g.*, Grant Hanessian & Francisco Franco, *Latin America Overview: A Long Road Travelled; A Long Road to the Journey's End: International Arbitration*, ICLG.com (Aug. 22, 2019), https://iclg.com/practice-areas/international-arbitration-laws-and-regulations/8-latin-america-overview-a-long-road-travelled-a-long-road-to-the-journey-s-end.

47. *Id.*; *see also* Quiñones Cruz, *supra* note 16, at 538 (describing the law in Argentina that prohibits the country to waive judicial review).

48. *See, e.g.*, Mary H. Mourra, *The Conflicts and Controversies in Latin American Treaty-Based Disputes*, *in* Latin American Investment Treaty Arbitration: The Controversies and Conflicts 5, 22–23 (Mary H. Mourra ed., 2008).

intervention and threats to sovereignty.[49] These sentiments carry on, with much more force to the international tax scene.

III. Latin American States' Opposition to Mandatory Tax Treaty Arbitration

Although most (or all)[50] Latin American officials and tax experts expressing their and their countries' opposition to mandatory tax treaty arbitration refrain from the mention of the Calvo doctrine and the history of Latin American opposition to arbitration in general and international arbitration of economic disputes in particular, the sentiments behind such opposition clearly reflect a continuing distrust among Latin American countries of this device despite the tremendous changes and vast adoption of arbitration in the region, even for investment disputes between states and foreign investors. These changes and the de facto unimportance of the Calvo doctrine in international law are, one may speculate, perhaps the reason for the apparent independent objection to international arbitration in tax matters in Latin America. This Article doubts such speculations. A more likely explanation is that tax exceptionalism is in play also in this issue, feeding on the long-standing suspicion of arbitration, with the Calvo doctrine being for a while its most central articulation.

It is common to view tax as the last bastion of sovereignty in a world in which nation states are becoming increasingly interdependent, leaving their rulers feeling as if such dependence somehow reduces their sovereignty. A careful study of sovereignty demonstrates that in many ways such perception is false, at least so far as the modern concept of sovereignty is concerned, because the core of the sovereignty concept in its modern sense is the prevention of chaos, which policy interdependence should not impact.[51] Yet, the feeling that they are restricted in their

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49. *Id.* These effects are particularly pronounced recently in countries impacted by populist movements, such as Venezuela. *See, e.g.*, *id.* at 8.

50. The author has never heard a mention of Calvo or the Calvo Doctrine in the large number of academic and professional events where such opposition had been expressed. Similarly, not even a single person asked about these names and terms or expressed familiarity in a large, but anecdotal, number of inquiries made by the author to the same people.

51. *See, e.g.*, Yariv Brauner, *An Essay on BEPS, Sovereignty, and Taxation*, *in* Tax Sovereignty in the BEPS Era 73 (Sergio André Rocha & Allison Christians eds., 2017).

margins of action is real and true, and increasingly tax policymaking is not and cannot be completely controlled at the domestic level. All nations face this reality, yet poorer and less powerful countries come under more pressure, politically, due to this reality because the general decrease of control over their fiscal situation is mixed with the fear that the more powerful nations use the situation to further take advantage of their weakness and add to their relative weakness in determining their economic future.

Latin American countries subscribe to this paradigm more than any other subset of countries, partly based on their histories and the long-standing fear of foreign intervention that gets mixed with their current fragility. The dominance of the OECD over the international tax regime and the increasing aggressiveness of the organization to impose its views over the rest of this world as it fights for survival, behavior best manifested by the BEPS project, serves as proof that the threat to the tax sovereignty of Latin American countries is real. Unfortunately, arbitration, even though it has not been part of the mandatory BEPS prescription, or even been widely agreed on in BEPS, became to some the symbol of all that is bad about the international tax regime, undoubtedly due to the past suspicion of the practice in the region.

The key rhetorical point is therefore the threat that arbitration presents to the tax sovereignty of Latin American countries. This is not unique for these countries. Developing countries more generally have rejected mandatory arbitration as proposed by the OECD back in 2007,[52] refusing to include such provisions in their tax treaties. Moreover, one should not assume that only developing countries rejected the proposal since in fact only the United States, and even there only in a few treaties, made significant progress on the matter, including mandatory arbitration in tax treaties and engaging in actual arbitration procedures based on these provision.[53] Even the most recent visitation of the matter, in the form of an opt-in part of the Multilateral Instrument (MLI),[54] has

52. *See* OECD*, Improving the Resolution of Tax Treaty Disputes*, *supra* note 11.

53. *See supra* note 13. Moreover, the adoption of the 2007 report on mandatory arbitration was not the first time the OECD considered the matter. In the early 1980s, the OECD had rejected for instance a well-known study of the matter. *See* Gustaf Lindencrona & Nils Mattsson, Arbitration in Taxation (1981).

54. *See supra* text accompanying note 14.

not garnered support from all OECD countries (although a much larger number of countries committed to it this round).[55] Again, no Latin American country, very few developing countries, and no country significant in size opted in.[56]

The substantive opposition to tax treaty arbitration is difficult to pin down since it does not rely on a single statement or idea, and there has not been an organized response to the proposal to improve treaty dispute resolution with mandatory arbitration; it is rather scattered in various, mostly unofficial statements that one could best learn about via scholarly and professional compilations and assessments.

The first set of claims are legal in nature: either international arbitration does not have a domestic law basis, or it is somehow in conflict with constitutional provisions (often supplemented by the claim that such constitutions prohibit delegation of policymaking or similar powers). The brief survey above and the vast literature about trade and investment agreements involving Latin American countries easily demonstrate that these claims are weak at best.[57] All Latin American countries have been through this; when they fought dispute resolution in trade and investment, they effectively abandoned the strong version of the Calvo doctrine and participated in many treaties and treaty-based arbitration procedures. There is nothing special about tax in this regard. Besides, in essentially all Latin American countries once arbitration is agreed upon in a treaty it is valid law, domestic-made law, and therefore cannot be claimed to somehow violate sovereignty or the independence of such countries to make their own laws.[58] The best proof is in tax treaties themselves: their entire content includes concessions of tax, typically by source countries, as which most Latin American countries view themselves; it is therefore puzzling why only the arbitration procedure, which does not necessarily involve concessions of tax, is viewed as so offensive while the other provisions that always involve tax concessions are not.[59]

A much more complex question is whether arbitration is right for Latin American countries. Another articulation of this question may be to doubt the realness of the freedom to adopt arbitration in

55. *See MLI Signatories and Parties*, *supra* note 15.
56. *Id.*
57. *See, e.g.*, Quiñones Cruz, *supra* note 16, at 537–38.
58. *See also id.* at 535.
59. *Id.* at 539.

international economic (and now also tax) treaties. One could justifiably argue that to a large extent Latin America was forced into the international standard, because the alternative would have been insufficient investment or even retaliation by the more powerful nations of the world. The discussion of this important potential argument is important but beyond the scope of this Article since it is quite clear that in tax matters arbitration is not the international standard, and one would find it difficult to argue that Latin American countries are somehow forced to adopt it in their tax treaties since in fact they (and many other countries) had not done so. This Article argues, however, that they should revisit that decision.

A derivative argument is that arbitration takes away the power of a country to make its own tax law since such a procedure may find against the position of the country, forcing it to apply law that is different from what it agreed on. This, again, is a false argument: treaties are indeed always incomplete agreements that require interpretation, and it is always possible that the final interpretation would not match that of any one government (in fact, that is always the case in treaty disputes). This is part and parcel of any agreement, but clearly of international agreements.[60] If at all, it is the treaty, not the arbitration procedure, that limits the tax sovereignty of a country.[61] Moreover, even at the domestic level a court may find against a government interpretation of any law. That could not be considered a violation of sovereignty, so why would a differing treaty interpretation be so offensive? After all, the assumption is that the treaty had been agreed upon by the parties so it could not jeopardize any key national interests (at least no reasonable interpretation of the treaty could have this effect). Consequently, no reasonable arbitration award could be counter to the national interests of a signatory country.[62] Any potential exception should be clearly excepted from arbitration or not included in the treaty.

Another perspective of the sovereignty question considers the alternative, and, in the case of the debate over mandatory tax treaty arbitration, the only current alternative to arbitration is some double taxation. One cannot expect the developed nations to simply concede their competing position in cases of disputes. Consequently, one should

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60. *Id.*

61. *See also, e.g.*, Mario Zuger, Arbitration Under Tax Treaties 32 (IBFD, 2001).

62. *See also* Quiñones Cruz, *supra* note 16, at 537.

evaluate what is more damaging for a country's (a Latin American country in this case) sovereignty: mandatory arbitration or the façade of administrative independence surely resulting in actual double taxation and an increase in the cost of investment in such country against which it can do nothing? The outcome of adopting mandatory arbitration is of course speculative, yet, put this way, one wonders whether a valid argument could be made in favor of keeping things as they are.

Considering the weak substantive opposition to the inclusion of mandatory arbitration in tax treaties, one must conclude that the problem that Latin American countries have with arbitration is their rooted distrust in the international economic system, meaning that is what needs to be addressed. Moreover, the assumption behind the above rebuttal of the arguments against tax arbitration is that it will be fair and reasonably conducted, so the focus of the discourse must be on the design of tax arbitration rather than its initial acceptability.[63]

Conclusion: Arbitration Is Not the Problem

Trust is the beating heart of human society, yet it is deceptively hard to establish and maintain. Trust has particularly eluded nation states in their quest for growth and development on the one hand and their insistence on maintaining traditional perceptions of sovereignty on the other hand.[64] Fiscal sovereignty is not the only aspect of sovereignty that found itself vulnerable with the intensification of globalization and the interdependence of states, yet for many states it is almost the last bastion of sovereignty and domestic control. This perception of fiscal independence is, however, false, since essentially all the world economies are interdependent and simply cannot successfully pursue purely individual policies that do not consider policies adopted by their trade partners.[65]

The frustration over this inability to form one's independent policies is particularly acute among developing countries that equate a

63. *See also id.* at 538 (providing a slightly different variation of this argument, emphasizing the lack of precise distinction, among those who claim that arbitration threatens the sovereignty of Latin American countries, between the power to make tax policies and the power to collect the taxes due).

64. *See, e.g.*, Brauner, *supra* note 51.

65. *See, e.g.*, OECD, *Action Plan on Base Erosion and Profit Shifting*, *supra* note 5, at 20.

lack of independence with oppression by the more powerful economies, even though even the most developed countries experience a similar phenomenon. In tax, the dominance of the OECD—the rich countries' club—over the international tax regime and such organization's increasingly belligerent behavior during the BEPS project exacerbated this frustration among developing countries. Such frustration has fallen on fertile ground in Latin America, where the lack of trust in the West in general and the OECD in particular had already been particularly heightened and the history of suspicion of foreign intervention had been rich.

Such history directed much of the antagonism against the OECD and BEPS at the arbitration proposal that had not even been part of the core BEPS policy prescription.[66] There should be no doubt that the remnants of the Calvo doctrine continue to affect Latin American attitudes toward tax arbitration, despite the demise of the actual doctrine and the lack of direct reference to it or to its more modern manifestations, and despite the effective abandonment of the rejection of arbitration by Latin American countries in the original battlefield of international trade and investment law. It is not law nor is it policy considerations that feed the anti-arbitration sentiments in Latin America but rather the deep lack of trust in the international institutions.

If indeed the lack of trust is the key hurdle, then that is what needs to be addressed. Of course, this Article assumes that arbitration done in a reasonably fair manner should benefit developing countries when compared to the current international tax dispute resolution regime that relies on mutual agreement—a fair assumption since in direct negotiations the developed nations are likely to possess more power and more resources than the less developed, advantages that are likely to be less advantageous in a system that includes mandatory arbitration. Even when the less developed country resists the pressure and refuses to conclude a mutual agreement procedure based on the dictates or the more powerful position of their developed counterparties, they necessarily find themselves at a disadvantage since they are less likely to be able to collect the tax in question, being more sensitive to and in need of foreign investment, or, if able to collect, the impact of double taxation will likely be greater for them compared to the other countries, increasing the cost of investment within their jurisdiction. Arbitration, especially

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66. The exact status of arbitration in the complex of BEPS proposals and implementation is worthy of independent study, yet it is beyond the scope of this Article.

in the format proposed by the OECD (mandatory baseball arbitration "kicking in" when mutual agreement fails to resolve a dispute[67]) balances at least some of these disadvantages of developing countries. This is the case of course only when arbitration is designed fairly and gains the trust of the participating nations.

Building trust in international dispute resolution institutions is difficult. The history of suspicion and the recent fragility of the trade and investment regimes only exacerbate this difficulty. Yet, one could, and this Article argues that one also should, learn the lessons of such fragility rather than simply reject tax arbitration on this basis. The international tax regime, being behind the other international economic regimes, could benefit from their lessons and perhaps leapfrog them or at least avoid many of the birth pains that they have suffered in the establishment of their dispute resolution regimes.

Providing a prescription for a Latin America accepted arbitration is beyond the scope of this Article, whose purpose is to demonstrate that neither the Calvo doctrine nor other substantive arguments stand in the way of such enterprise. However, a few observations may be useful and apt for future research and debate. First, the increasing number of investment arbitrations having a seat within Latin America when involving solely Latin American parties could be used as a precedent. Having the seat of arbitration in the region, and perhaps more importantly, not always in Europe, could send an important signal that is not one of foreign intervention. Second, the choice of arbitrators may similarly signal control of the West and its "experts" over developing nations. The WTO system, which uses panelists from the region, could be used as an example to further relieve suspicion of Western control over the process. One comment that is often made in this context is that there are not enough international tax experts, and even fewer experts with no conflicts of interest in developing countries, to fill a cadre of arbitrators. This issue should be carefully addressed, but expanding the cadre regionally, adopting a reasonable "clean hands" approach rather than strict no conflict standards, sticking to "baseball" arbitration, requiring a reasoned opinion in only appropriate instances, and having effective control mechanisms could go a long way to relieve these concerns. One should be mindful also that the hope in adopting mandatory arbitration clauses is that they would encourage the parties not to reach arbitration

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67. *See generally* Joost Pauwelyn, *Baseball Arbitration to Resolve International Law Disputes: Hit or Miss?*, 22 Fla. Tax Rev. 40 (2018).

but rather to resolve their disputes prior to that. Finally, the question of applicable law is tricky in international taxation, which lacks supranational norms but includes a rather comprehensive set of soft law norms based on the OECD Model, which in turn may feed the concern that OECD norms would dominate any arbitration proceedings and deter developing countries' participation in arbitration. The design of the arbitration proceedings and of tax treaties signed by such countries could, however, relieve much of such concerns, since essentially all arbitration procedures will involve interpretation of tax treaties. Safeguarding these procedures from clearly unacceptable interpretations (even to the extent of explicit rejection of interpretation based on the OECD commentary, for example) could again go a long way to relieve these concerns.

The ghost of the Calvo doctrine should not therefore haunt Latin American countries in their conduct within the international tax regime. They, as well as all other countries, should try and find the design that would permit them to benefit from international tax arbitration rather than to dogmatically reject it to their certain disadvantage.