THE TAX ARBITRATION AND THE BACKGROUND OF THE STATE'S CAPACITY IN PANAMA TO SUBMIT TO ARBITRATION

BY PUBLIO CORTÉS

There is a book that should perhaps be a mandatory reading for every lawyer in Panama. It is called STUDIES OF PANAMANIAN CONSTITUTIONAL LAW [1], and it is a compendium that JORGE FÁBREGA PONCE made in 1987 of 42 essays by 30 authors, most of them Panamanian Lawyers, on matters of all kinds of Panamanian Constitutional Law. General topics, specific topics and also matters of Constitutional History of Panama are addressed.

The value of this book is that, all of its essays were written in the heat of the constitutional reform suffered by the 1972 Constitution, through the 1983 Constitutional Act, when the military dictatorship, pressured by the United States after the signing of the Torrijos-Carter treaties, was supposedly taking opening steps with a view to democratizing the country, allowing elections. The changes made to the autocratic Constitution of 1972 were such, that Dr. CÉSAR AUGUSTO QUINTERO CORREA, one of its editors, used to say that the 1983 Constitution was a "new" Constitution. Much of the Constitution in force today in Panama is the result of that reform.

"We are what we are because we were what we were"
Arturo Pérez-Reverte.

[1] FÁBREGA P., Jorge (Compiler), *Panamanian Constitutional Law Studies*, Editora Jurídica Panameña, Panama, 1987.

Therefore, many of the comments that appear in said book are illustrative of the general understanding of the constitutional institutions that resulted from that 1983 reform.

After the 1983 reform, the Constitution of Panama has suffered changes through the Legislative Acts of 1992, 1994 and 2004.

In the aforementioned book an essay was published entitled: "The State's ability to enter into arbitration agreements",[2] written by my Professor OLMEDO SANJUR C., Professor of Administrative Law of the University of Panama, former General Attorney of the Administration and consecrated Litigant. His reasoning is deeply illustrative of the antecedents of the issue regarding the possibility of the interests of the State may be subjected to arbitration.

The purpose of this document is mainly to summarize the elements of judgment presented by Dr. SANJUR in his 1987 essay, as a reference element of the academic debate that exists on the possible constitutional viability of arbitration about tax matters.

To that end, it is important to take into account that on the date that this essay was written, the article numbered today as 200, in numeral 4, of the Political Constitution, had **only** the following text:

"*The functions of the Cabinet Council are:.....*
4. Agree upon, with the President of the

Republic, that he may compromise or submit to arbitration the litigious matters in which the State is a party, for which the favorable opinion of the Attorney General of the nation is necessary."

This text remained unaltered after the 1992 and 1994 reforms.

It isn't until the Legislative Acts of 2004 that a second paragraph was added to the previous text. However, we will deal with this after summarizing Dr. SANJUR's work.

Our summary of Dr. SANJUR's essay

The essay is divided into five sections, each with a Roman numeral. We shall follow that order.

The first section is called "**I. General ideas to introduce the topic**". In this section, a premise of the whole study is put forward, which is related to the profound difference existing between the legal position of an individual if we compare it with the legal position of a State entity, since the latter compromises public interests. "*If this*

[2] Page 763.

premise is not taken into account -he mentions- it is difficult to reach an appropriate conclusion or a properly grounded criterion on the subject."

The second section is called "**II. The principle of legality**". It reminds us that this principle is "*the basis of Public Law*" and "*is specified in the practical formula that in Public Law you can only do what the Law expressly authorizes*." It emphasizes the nullity that would occur if a public body or official enters into a legal act or negotiates an agreement, without being duly empowered by law to do so.

It cites the constitutional support of the regulations which establishes, that the authorities must comply with and enforce the Constitution and the Law, and that they are responsible for excess of functions. It adds that this concept was upheld in a ruling of the Contentious-Administrative Chamber of the Supreme Court in 1966 and concludes the section stating that: "*Therefore, for a public body or official to enter into an arbitration agreement or submit a controversy in which the State is a party, it must be expressly empowered to do so by law.*"

The third section is called: "III. What is an arbitration agreement?". The author immediately shares a first definition with us: "*The arbitration agreement is the act by which the parties agree to submit a future controversy to the decision of third parties, either to be resolved according to law or according to conscience.*" He later quotes the Master DULIO ARROYO CAMACHO, who, in VOLUME II of his CIVIL CONTRACTS, wrote:

"*COMMITMENT CLAUSE OR COMMITMENT COVENANT. This is understood as the clause that the parties introduce in any contract, which is recorded in writing, and in which they agree to submit to the judgment of arbitrators the differences or conflicts of interest that may arise between them in the **future**, due to of certain legal relationships. But it can be agreed, as an autonomous convention ...*

*... Its main difference with the commitment contract lies in that, this last supposes a current conflict; that is, existing between the parties, while the arbitration clause or the arbitration agreement are agreed upon in anticipation of controversies that **may arise amongst them in the future**. Furthermore, the first one is a definitive contract, whilst the arbitration agreement is only a preparatory arbitration contract. From the foregoing it turns out that the commitment contract immediately leads to the so-called arbitration trial; on the other hand, neither the arbitration agreement nor the arbitration clause produce that effect.* " (The underlining is ours).

After analyzing this quote, the author SANJUR concludes with another definition of the concept of arbitration

agreement: "*Hence, the arbitration agreement is the one agreed upon by which the submission to an arbitration tribunal of a* ***future controversy*** *derived from a specific legal relationship.*" (The underlining is ours).

The next section is called: "**IV. Do public officials or bodies have the power to enter into arbitration agreements in Panama, on behalf of the State?**" At the beginning, it recalls the Principle of Legality already explained and reiterates that public officials can only submit matters of public interest to arbitration if the Law authorizes them and quickly opts for the line that it does not seem that this generic authorization exists in Panama, a matter that he supports with a quote from Official Notice No. 45 of January 26, 1971, by means of which the Attorney General of the Nation at the time said the following to the General Comptroller of the Republic:

"*Hence, do share your criteria, Mr. Comptroller,*[3] *indicative that '****it is not convenient to remove public interests from the jurisdiction of the Courts, to submit them to the decision of individuals, which ultimately are those that make up an arbitration tribunal****', in addition to the fact that 'this procedure does not meet the necessary assurances in the management of public interests, since it even omits motions that must be obligatorily exercised before the ordinary courts, when the decision is adverse to said interests.*" (The underlining is ours).

After this, Dr. SANJUR expresses one of the most important ideas of his entire essay, namely: "As the power has been instituted to submit litigation matters to which the State is a party to arbitration, surrounded by important formalities and requirements in the Constitution itself, this indicates that it is the **desire of the Panamanian Constituent that only by exception the controversies of the State are submitted to the decision of arbitrators.** All our constitutions (those that have regulated the matter) indicate this." *(The underlining is ours).*

He then reviews the constitutional texts to which he makes reference.

The story begins with the **Constitution of 1941** (Article 124, 2nd ordinal), where one of the functions of the Cabinet Council was indicated:

"*During the recess of the National Assembly, to empower the President of the Republic so that he may submit to a trial of arbitrators the litigious matters in which the nation is a party thereof and to settle them. For this it is necessary the unanimous vote of the Council and hear the concept of the Attorney General of the Nation*".

In other words, according to that Constitution, it was the power of the National Assembly to empower the President to submit litigious matters to arbitration where the State is a party. Only during its recesses, could the Cabinet Council play this role, but only with an unanimous vote, after having listened to the Attorney General.

For the Constituent Assembly of 1946, **Drs. JOSÉ DOLORES MOSCOTE, RICARDO J. ALFARO and EDUARDO CHIARI presented a preliminary draft**

[3] The Comptroller's criteria was set forth in Official Letter 1-Leg of January 4, 1970.

whose article 160, 2nd ordinal, says that it was the duty of the Cabinet Council: "*In recess of the National Assembly, empower the President of the Republic so that he can compromise or submit to arbitration the litigious matters in which the Nation is a party thereof. This requires the favorable opinion of the Attorney General of the Nation and the unanimous vote of the Council*".

This preliminary draft increased the rigor of the 1941 constitutional text. Indeed, in addition to maintaining everything that is in the 1941 Constitution, it added that the concept of the Attorney General had to be positive, in case the matter passed to the Cabinet Council by recess of the Assembly.

The final result of the **1946 Constitution** was even more rigoristic, because not only did it accept the draft by MOSCOTE, ALFARO and CHIARI, but also introduced the approval of a Permanent Legislative Commission, in situations of recess of the Assembly. Article 162, 2nd ordinal, established that it was the duty of the Cabinet Council:

"*In recess of the National Assembly, to empower the President of the Republic so that he can compromise or submit to arbitration the litigious matters in which the Nation is a party thereof. This requires the favorable opinion of the Attorney General of the Nation and the unanimous vote of the Council and that of the majority of the Permanent Legislative Commission*".

From the above, we then go to the **Constitution of 1972**, in the military regime, where there is no National Assembly itself and the President is not the product of elections, so Article 180, numeral 4, removes the participation from the Assembly on the matter, and concentrates it on the Cabinet Council, who no longer "empowers" the President but has to "agree" with him, without the need for a unanimous vote, maintaining, however, the favorable concept of the Attorney General of the Nation. The regulation says that it will be the function of the Cabinet Council:

"*To agree upon, with the President of the Republic, that he can compromise or submit to arbitration the litigious matters*

in which the State is a party thereof, for which the favorable opinion of the Attorney General of the Nation is necessary."

Finally, Dr. SANJUR goes to the current text when the essay was written, that is, the **1972 Constitution**, amended by the 1983 Constitutional Act. That Constitution kept the text already cited intact from the original 1972 Constitution. Dr. SANJUR makes a criticism. After stating that the text was not changed, he adds that this was done: "*...forgetting that when a Legislative Assembly was instituted with duties similar to those assigned to the National Assembly in 1946, it had to recover its duties of authorizing to the President to submit disputed matters to which the State is a party to arbitration.*"

The foregoing sustains that, at that time, Dr. SANJUR was in favor of granting the authority to authorize the declination to Arbitration, to the Legislative Branch, who gave "permission" to the President of the Republic to do so. However, that never made it back.

After reviewing this constitutional evolution, the author addresses what was a topic of debate at the time the essay was published. That is: **if it was possible that the Executive Branch, in exercise of its public contracting power, could include compromising clauses in public contracts, to agree on future arbitrations without having to require the above-mentioned authorizations that includes the approval of the Attorney General of the Nation.**

Dr. SANJUR thinks that it is NOT possible and supports it in the following way:

"*It cannot be understood that these constitutional regulations guarantee the safety of the possibility, that public officials in exercise of their contracting power, can agree to arbitration in advance and, therefore, include the arbitration clause in administrative contracts or enter into an arbitration agreement, for a simple reason. In all the constitutional provisions that have been regulating the functions of the Cabinet Council, it has been expressly included, as one of the attributions of that body, 'to agree to the conclusion of contracts' ... however, the following line is assigned as a different attribution that of 'agreeing with the President of the Republic that he may ... submit to arbitration the litigious matters in which the State is a party' ... Thus, for the Constituent there are two different powers, since otherwise I would not have included the last one in the same article.*"

And he then concludes: "*Therefore, it must be concluded that, in accordance with our Constitution, the Executive cannot, in view of it's contracting power, agree in advance to submitting to arbitration a future controversy in which the State is a party thereof.*"

IMPORTANT: I respectfully call the attention of the readers of this Bulletin, to bear in mind the legal debate that I have reviewed in the immediate previous citations. We will return to this later, because it is a light that helps us to forcefully explain the rationale of the drafting of the constitutional regulation currently in force, which in no way allows to give constitutional support to tax arbitration.

We continue with the summary of Dr. SANJUR's essay.

After stating its position as to the impossibility of including arbitration agreements in public contracts, without the authorization of the Cabinet Council, the essay goes on to comment on an exceptional case on this rule, which is derived from the ruling of the Supreme Court, en bank, on February 19, 1979, which authorized that arbitration agreements can be included in the cases of a Contract-Law, but understanding that they must be within the Law.

This practice, which has been accepted, for example in the cases such as that of Refinería Panamá, S.A., Petroterminal, S.A. among others, reflects widespread behavior in transnational companies that do not want to submit to national courts.

Next, Dr. SANJUR deals with the issue of Public Order and matters that may or may not be submitted to arbitration, thus:

"*Not all litigious matters may be susceptible to a decision by an arbitration court, especially those cases in which the State is a party thereof. … … …*
The foregoing is justified because ***matters governed by rules of public order or social interest****, which are inexcusable,* ***cannot be submitted to the decision of the arbitral courts****, especially when they must decide in conscience.* ***For example, tax matters that arise to contentious-administrative disputes****, criminal matters, etc.*" (The underlining is ours).

Finally we have the last section of the essay entitled: "**V. Is the International Convention on International Commercial Arbitration applicable to State disputes?**" Dr. SANJUR refers to the convention approved by Law 11 of 1975. The answer provided is that it does not apply, because it is a convention related to commercial matters and not to public affairs.

Useful lessons from Dr. SANJUR's essay, for the academic debate on Tax Arbitration

(1) The historical tendency of the Panamanian constituent has been to RESTRICT arbitration where the State is a party. From 1941 onwards, there was always talk of very closed controls set at the highest level of the State Bodies, after which a case could be declined to arbitration, as an exceptional situation. Even today that is the dominant trend of the constitutional text.

(2) Upon constitutionally interpreting the issue of possible arbitrations where the State is a party thereof, the historical constitutional legal tradition that has been outlined must be a source of law, not only because it is part of what the Supreme Court has called the "Block of Constitutionality", but because this is also indicated by a standard of Common Law, contained under article 13 of the Civil Code, whose text reads as follows: "***Article 13****. When there is no exact applicable law to the controversial issue, the laws that regulate cases or similar matters, and failing that, the* ***constitutional doctrine****, the general rules of law, and custom, being general and in*

accordance with Christian morality shall be applicable." (The underlining is ours).

(3) Upon speaking of an arbitration agreement, FUTURE conflicts were always kept in mind. This is how Dr. DULIO ARROYO CAMACHO and Dr. SANJUR understood it. It was not an option at any time, to speak of declining arbitration of a conflict already started, where the State was a party.

(4) As can be seen, from 1941 to date, it was never even proposed as an option to submit the tax issue to arbitration. In fact, the only mention that Dr. SANJUR makes on the subject is to say that it is NOT possible, because the tax issue is a matter of public order, thereby joining the criteria of other national jurists, as is the case of the Dr. GILBERTO BOUTIN, in his work ON COMMERCIAL ARBITRATION.

(5) The only debate that has in fact arisen since the 80's, was on the possibility whereas the Executive Branch could include arbitration agreements in **public contracts** (not taxes), without having to request authorization from the Cabinet Council and favorable opinion to the Attorney General of the Nation. We have already seen that Dr. SANJUR ruled against this possibility, except in the case of Law Contracts under established jurisprudence of the Supreme Court. We deal with that issue in the next section.

The debate on the possibility of including arbitration agreements in public contracts and its relationship with the 2004 constitutional reform

Let us first review the debate to which we make reference.

In order to solely speak of the period after the constitutional reform of 1983, we can say that in the approximate 20 years that go from 1983 to 2003, the following regulations on the duties of the Cabinet Council were in force:

"*The functions of the Cabinet Council are:*
... .

3. ***Agree upon the celebration of contracts****, the negotiation of loans and the sale of personal or real estate assets, as determined by the Law;*

4. Agree with the President of the Republic, so that he may compromise or submit to arbitration the litigious matters in which the State is a party thereof, for which the favorable opinion of the Attorney General of the Nation is necessary;" (The underlining is ours).

With this constitutional text, the object of debate was basically the following:

POSITION 1: Some argued that based

on numeral 3, that is, the generic possibility of entering into contracts, it was possible to include arbitration agreements in public contracts, if in the future a dispute arose in which the State was a party, related to that contract, it was agreed in advance that it would be resolved by Arbitration, without having to apply paragraph 4 of the same article.

POSITION 2: On the contrary, there were others who said that this was NOT the case. Because if the Constitution had restricted rules for Arbitration in the following numeral, it is because this is a special and subsequent issue and it meant that the Constituent wanted that everything related to Arbitration in which the State was a party, had to be looked at under the optics of this specific case of numeral 4. Dr. SANJUR supported this position.

It is my understanding that **POSITION 2** triumphed, because at that time, except in Law Contracts, arbitration agreements were not included in public contracts.

The Legislative Act of 2004.

Then came the Legislative Act of 2004, in which, through the outgoing Assembly under the Moscoso Administration, and then ratified by the incoming Assembly under the Torrijos Administration, several changes were made to the Political Constitution.

One of those changes was the addition of a paragraph to the rule of authorization of Arbitration in disputes where the State is a party.

By virtue of the foregoing, the text in force after the 2004 reform and as of today is the following:

"*ARTICLE 200. The following are duties of the Cabinet Council:*
… … …

3. Agree on the celebration of contracts, the negotiation of loans and the alienation of national personal or real estate property, as determined by law.

4. Agree with the President of the Republic that he may compromise or submit to arbitration the litigious matters in which the State is a party, for which the concept favorable from the Attorney General of the Nation is necessary;

This paragraph will not apply to arbitration agreements contractually agreed upon by the State, which will be effective by themselves."

The new paragraph added to numeral 4 of the standard that we have just cited, confirms that **OPTION 2** summarized above and with which Dr. SANJUR aligned, was the triumphant criterion. So much so, that the defenders of **OPTION 1** (I assume that in consensus with the defenders of **OPTION 2**), decided to reform the Constitution to make their approach feasible.

In other words, the only explanation for the exception contained in the second paragraph of numeral 4 of the current Article 200 of the Political Constitution is that, it sought to enable the previously non-existent possibility, that arbitration agreements could be included in public contracts for if, in the future, a dispute

will arise in which the State is a party, related to that contract, it was agreed in advance that it would be resolved by arbitration.

It is for this reason that, since 2004, it is already common to see public contracts with an arbitration agreement in the administrative practice of Panama.

Moreover, according to the Constitutional System of Panama in force to date, only arbitration agreements can be included for future litigation declination on the arbitration sphere, without going through the controls established in the first part of paragraph 4 of Article 200 of the Political Constitution, in two cases:

1. When it comes to Law Contracts.
2. In the case of Government Procurement which have been reached after applying the corresponding legislation.

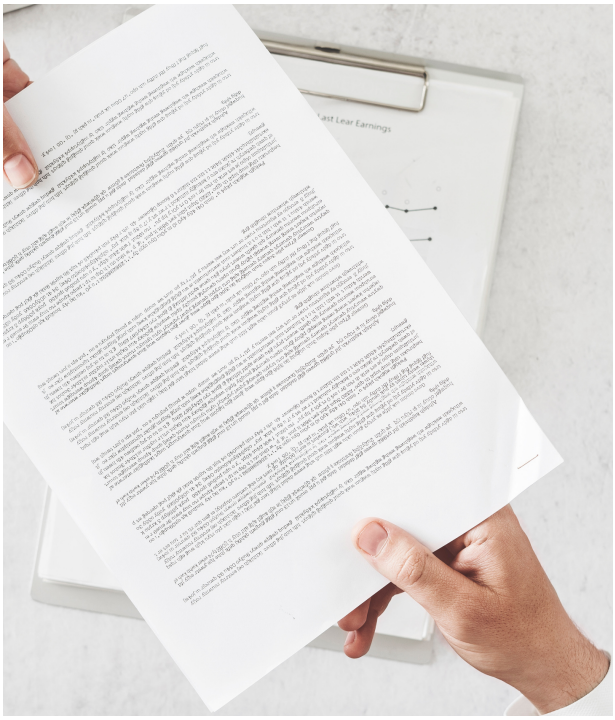
Other than the above, all litigious cases, **including tax cases**, where the State is a party thereof, that want to be taken to a decision by an Arbitration, require an agreement between the Cabinet Council and the President of the Republic, in addition to the favorable opinion of the Attorney General of the Nation, regardless of the amount.

Is there any way that the tax issue can be included in the exception of the second paragraph of article 200, numeral 4, of the current Political Constitution?

Definitely NOT. For multiple reasons, including the Constitutional History, for me however, the most obvious reason refers to the nature of the source of the obligation involved.

As already explained, the history of the arousal and literal wording of the second paragraph of article 200, numeral 4, of the current Political Constitution, shows that it refers to arbitration agreements within CONTRACTS. The source of obligation involved is public contracts. It is not by chance that Dr. DULIO ARROYO CAMACHO has addressed the subject in his famous book on CIVIL CONTRACTS.

However, the Source of the Obligation of the Treasury-Taxpayer relationship is of another kind. As a reference, let us read a comment on the matter written by Dr. JULIO ROBERTO PIZA, Professor and Researcher on issues of Public Finance Law and Tax Law at the UNIVERSIDAD EXTERNADO DE COLOMBIA and current Magistrate of the Council of State of Colombia, who defines tributes like this:



*"... An income of a pecuniary nature, of a public nature, obtained by a public entity, holder of a credit right, as a consequence of the **realization of a factual assumption established by law** as it is indicative of economic capacity and aimed at satisfying the financial needs of the State and other public entities."* (The underlining is ours).[4]

As observed herein above, the arousal of the tax obligation is NOT produced by a contract but rather, it arises from a duty imposed by law, in the event of the fulfillment of factual assumptions that activate the obligation. Therefore, the possibility that any tax dispute is declined to arbitration, where the State is evidently a party as creditor, is an issue that is only possible according to the general restricted constitutional rule, that is: by agreement between the Cabinet Council and the President of the Republic, in addition to the favorable opinion of the Attorney General of the Nation, regardless of the amount. Seeking different means, as that established by the Code of Tax Procedure, is contrary to the Political Constitution.

Final Comments

Herein, we have reviewed some of the factors by which the Tax Arbitration introduced in the Code of Tax Procedure of Panama is clearly unconstitutional. There are more reasons.

The truth of the matter is, that the patent unconstitutionality of the Tax Arbitration is just one of the many technical problems which this code sadly suffers, which reflect a lack of legal thoroughness, superficiality and weakness in its integration with the rest of the legal system within Public Law of Panama.

There are issues however, that are not understood. To give you clear example: in this Bulletin, we have been able to see that since 1941, almost 80 years ago, since approximately the beginning of the Second World War, after all political currents passed through power, with the favorable concept of great Jurists like JOSÉ DOLORES MOSCOTE, EDUARDO CHIARI, RICARDO J. ALFARO, CÉSAR AUGUSTO QUINTERO CORREA, MARIO GALINDO HEURTEMATTE and many others, all the Constitutions of Panama, including the one in force today as well, have maintained that the power to "compromise" conflicts where the State is a party, corresponds to the President of the Republic, regardless of the amount and prior compliance with certain authorizations.

Nevertheless, in a more cheerful way, the Tax Procedure Code, under article 358, empowers the Director General of

[4] PIZA RODRIGUEZ, Julio Roberto. *The concept of tribute in the legal system,* Lesson 13, in the book by various authors entitled: FISCAL LAW, VOLUME I, Universidad Externado de Colombia, 2007, p. 383.

Revenues to "compromise" on national taxes. The regulation expressly establishes:

"The tax obligation may be extinguished through the transaction. The tax transaction is an agreement negotiated and signed by the Tax Administration with the taxpayer... "

It seems as if the Constitution does not matter. And, where are the powers of the President of the Republic? This is not the way to legislate.

I can accept the fact that perhaps, it is time to debate on whether it is convenient for the country to allow some kind of arbitration in tax matters, it may not be a bad idea to allow the Tax Administration to settle directly without asking permission from the Cabinet Council. Societies change and constitutional regulations can be left behind. What cannot happen, what is not right, is that the changes be made rashly, without using the provisions offered by the law.

The authorities have recently postponed the entry into force of the vast majority of the articles of the Code of Tax Procedure until January 2022. As there is no doubt that it is necessary to modernize the old and entangled regulations of the Fiscal Code, it seems to me that the prudent thing to do here, is to take advantage of this time to appoint a commission, in which not only experts on Tax Law participate, but also Constitutional Law, Administrative Law and Procedural Law, to carry out an orderly, plural, calm and scientific review, to achieve the best possible legislation. The Directorate General of Revenue and the National Bar Association could take the lead.

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