

# Compulsory arbitration

## 1. Current developments

### 1.1. Compulsory arbitration in tax treaties

Under most of the existing arbitration clauses in tax treaties, the initiation of the arbitration procedure is subject to the mutual consent of the tax authorities of both contracting states. Thus, these clauses only offer the *possibility* for an arbitration procedure in tax matters that is already provided for in general international law. However, the tax treaties concluded by the Netherlands with Egypt, Kuwait, Macedonia, Moldavia and Uzbekistan allow referral to the arbitration board by only one side. Such arbitration clauses are also included in treaties on road vehicle taxation, in which the contracting states mutually refrain from taxing foreign vehicles used only for a short period on their territory.<sup>1</sup> Disputes between various parties on the interpretation or application of these treaties on road vehicle taxation are to be resolved through negotiation. If the negotiations fail to bring about a settlement, each of the parties involved in the dispute may demand the establishment of an arbitration board. If the parties fail to agree on the use of an arbitration board, each of the parties may ask the Secretary General of the United Nations to appoint an arbitrator as a substitute, who will be entrusted with the case. Consequently, the tax treaties offer each party the *possibility* to initiate an arbitration procedure unilaterally, irrespective of the consent of the tax authority of the other state. It is not known whether an arbitration procedure has ever had to be initiated.

Recent tax treaty practice shows an increasing number of examples that not only facilitate referral to an arbitration board by one side but also *oblige* the tax authorities to institute an arbitration procedure when a taxation conflict cannot be settled by way of negotiation (hereinafter referred to as “compulsory” or “mandatory” arbitration). A milestone is the EC Arbitration Convention (which could better be called the EC Transfer Pricing Convention), which was concluded in 1990 after years of negotiations between the then 12 EU Member States.<sup>2</sup> The purpose of this convention is to eliminate double taxation resulting from the adjustment of profits of associated

---

<sup>1</sup> Convention on the Taxation of Road Vehicles for Private Use in International Traffic, 18 May 1956, UNTS 339, 3; Convention on the Taxation of Road Vehicles engaged in International Passenger Transport, 14 December 1956, UNTS 436, 131; Convention on the Taxation of Road Vehicles engaged in International Goods Transport, 14 December 1956, UNTS 436, 115; see Tittel, *Verständigungsverfahren*, 57.

<sup>2</sup> Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, 23 July 1990, *Official Journal* 1990 L 225, 10 as amended by the Convention on the Accession of the Republic of Austria, the Republic of Finland and the Kingdom of Sweden to the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, 21 December 1995, *Official Journal* 1996 C 26, 1.

enterprises. If the tax authorities cannot agree on a correct transfer price in a cross-border group of companies, they have to set up an arbitration body to find a solution to this taxing conflict. Thus, the Arbitration Convention provides for a binding arbitration procedure in the event of transfer pricing disputes. It does not, however, cover all other disputes that may arise in connection with tax treaties. Besides, the Arbitration Convention expired as of 31 December 1999. Although an amendment protocol for the extension of the Arbitration Convention beyond this point of time has already been signed, it has not yet entered into force.<sup>3</sup>

Taxation conflicts arise not only between EU Member States and they are not only in connection with transfer pricing issues. Therefore, it has already become part of some states' tax treaty policy to agree on compulsory arbitration procedures for all conflicts that may emerge with regard to the application of tax treaties. Germany, for example, has been attempting to do this for some time, yet has been unsuccessful due to the resistance of its negotiation partners.<sup>4</sup> Since Austria became party to the EC Arbitration Convention, it has also adopted a more open attitude toward binding arbitration agreements and in 1998 issued a draft arbitration provision to be included in new tax treaties with non-EU countries. Austria has already been able to convince Mongolia and Armenia, as well as – subject to further negotiations – Slovakia and Turkey, to agree on dispute resolution based on this draft. This will complement the provisions of the mutual agreement procedure, which correspond exactly to the wording of Article 25(1) to (4) OECD Model, by adding the following paragraph (5):

*If any difficulty or doubt arising as to the interpretation or application of this Convention cannot be resolved by the competent authorities within a period of two years after the question was raised pursuant to the previous paragraphs of this Article, the case shall, if all affected taxpayers agree, be submitted for arbitration by the competent authority that initiated the mutual agreement procedure. The arbitration board shall consist of one representative of each competent authority and one independent person per Contracting State taken from a list of arbitrators in the order of their nomination. The arbitrators shall elect a chairperson who must possess the qualifications required for appointment to the highest judicial offices in his country or be a jurisconsult of*

---

<sup>3</sup> Protocol of 25 May 1999 amending the Convention of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, *Official Journal* 1999 C 202, 1; Züger, "Das Inkrafttreten der Schiedskonvention in Österreich", *Steuer und Wirtschaft International* 1999, 394 *et seq.*; Bernhard, "Die Verlängerung der Schiedsverfahrenskonvention", *Internationale Wirtschaftsbriefe* 1999, Vol 11 EC, Group 3, 243 *et seq.*; Züger, "Die Anwendbarkeit der Schiedskonvention nach dem 1.1.2000", *Internationale Wirtschaftsbriefe* 1999, Vol 11 EC, Group 3, 257 *et seq.*

<sup>4</sup> Runge, "Entwicklungstendenzen zum DBA Österreich-Deutschland", *Steuer und Wirtschaft International* 1997, 201; see Killius, *intertax* 1990, 439. Switzerland, for example, is not willing to accept mandatory arbitration procedures "for state policy reasons": Lüthi, "Die Abkommenspolitik im internationalen Steuerrecht der Schweiz", *Archiv für schweizerisches Abgabenrecht* 1996/97, 187 *et seq.*

*recognized competence. Each Contracting State appoints five competent persons for the list of arbitrators. The taxpayer may at his request appear before the arbitration board. The arbitration board shall deliver its opinion not more than six months from the date on which the matter was referred to it. The decision of the arbitration board in a particular case shall be binding on both Contracting States and all taxpayers involved with respect to that case. (unofficial translation)*

## 1.2. General arbitration and conciliation treaties

Under general international law, states may accept arbitration on all future disputes that may arise between them. For example, Article 19 European Convention for the Peaceful Settlement of Disputes provides that the signatory states shall submit to arbitration all disputes which may arise between them and which have not been settled by conciliation or otherwise.<sup>5</sup> This excludes, however, all “legal disputes” within the meaning of Article 1 of this Convention. The interpretation of the treaties between the signatory states, in particular, falls within this category, since the Convention provides for the jurisdiction of the ICJ in such cases. Therefore, under the European Convention for the Peaceful Settlement of Disputes, it is not necessary to establish an arbitration board to deal with disputes arising from the interpretation or application of a tax treaty.

In reaction of the horrors of World War I, countless bilateral arbitration and dispute settlement treaties were concluded worldwide.<sup>6</sup> Disputes that could not be settled through negotiation or other peaceful means were to be submitted to arbitration or litigation. By doing so, states hoped to solve bilateral conflicts through law rather than force. Law was therefore to contribute to maintaining peace. Yet these treaties were never really of some importance in practice.<sup>7</sup> Some of these treaties obliged states to establish an arbitration board; others provided for referral to the Permanent Court of International Justice (PCIJ). Other treaties, however, combined both models and provide for the jurisdiction of the PCIJ if the parties cannot agree on submitting the dispute to an arbitration board.<sup>8</sup> As these treaties cover all kind

---

<sup>5</sup> European Convention for the Peaceful Settlement of Disputes, 29 April 1957, 320 UNTS 243, ETS 23; for more detail, see Miessler, “The European Convention for the Peaceful Settlement of Disputes”, in Kipp et al (eds), *Um Recht und Freiheit. Liber Amicorum Friedrich August Heydte I* (1977), 335 et seq.

<sup>6</sup> Comprehensive evidence by Habicht, *Post-War Treaties for the Pacific Settlement of International Disputes* (1931), 3 et seq.

<sup>7</sup> For more information on the reasons, see Grewe, *Friede durch Recht?* (1985), 17 et seq.; Randelzhofer, “Gründe für den nur beschränkten Erfolg der Kriegsverhütung durch Völkerrecht”, in Hailbronner/Ress/Stein (eds), *Liber Amicorum Karl Doehring*, 747 et seq.

<sup>8</sup> For more detail, see Mangoldt, “Arbitration and Conciliation Treaties”, in Bernhardt (ed), *Settlement of Disputes, Encyclopedia of Public International Law* 1, 28 et seq.

of disputes (legal and non-legal ones), they are also applicable on disputes arising from tax treaties.<sup>9</sup>

---

<sup>9</sup> Mülhausen, *Verständigungsverfahren*, 115; Strobl/Zeller, *Steuer und Wirtschaft* 1978, 257.