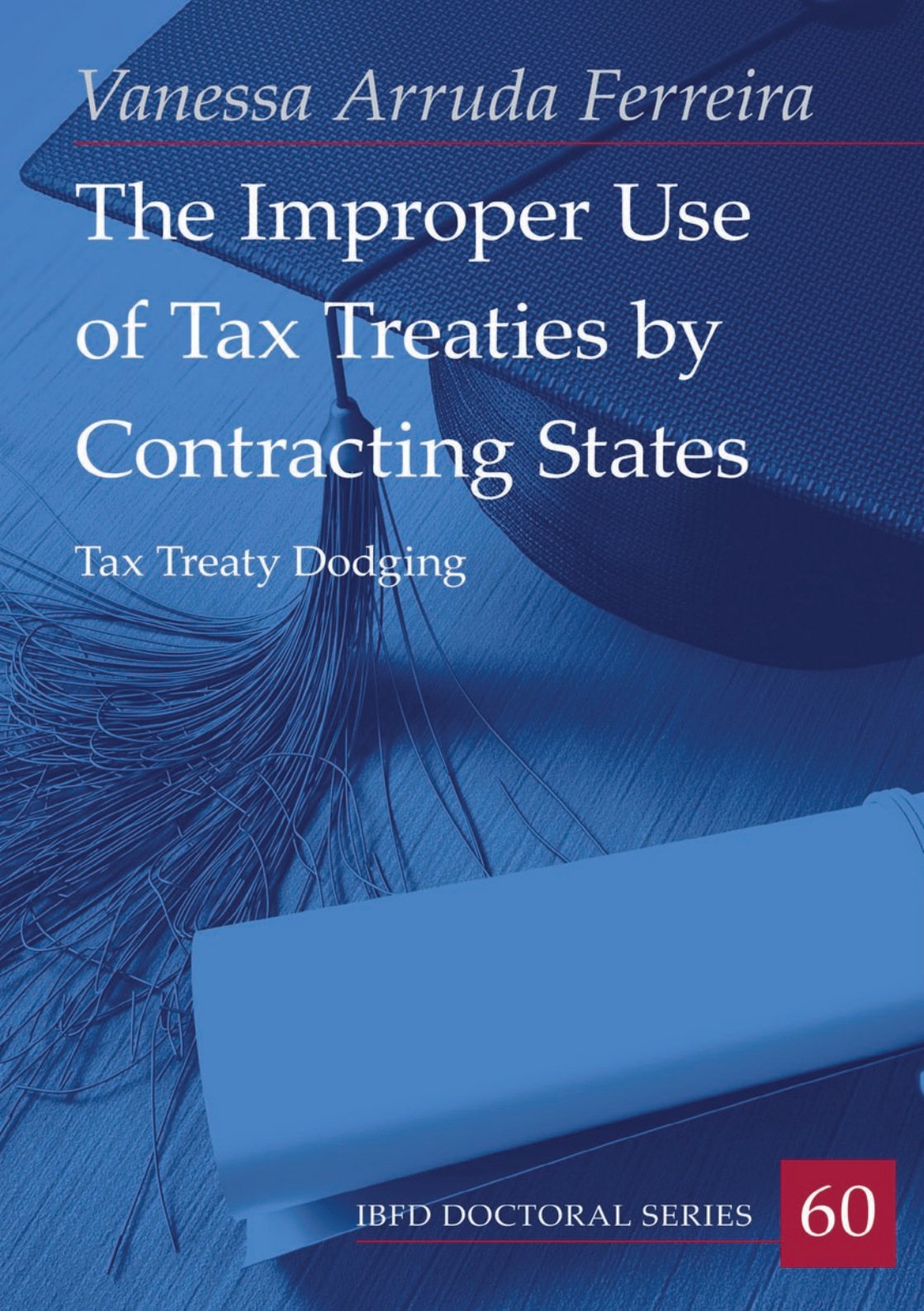
Vanessa Arruda Ferreira

The Improper Use of Tax Treaties by Contracting States

Tax Treaty Dodging



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The Improper Use of Tax Treaties by Contracting States

Why this book?
While an increasingly large space in tax literature has been dedicated to the different methods of tax avoidance used by taxpayers to reduce their tax liability, not much has been said on how contracting states may make use of comparable tactics to increase tax revenue or extend economic advantages for their own benefit. As much as taxpayers may design legal arrangements that work through legal loopholes with the view of avoiding taxes, contracting states too may circumvent obstacles or artificially stretch advantages in a way that complies with the wording of tax treaties but ultimately impacts the allocation of taxing rights and the tax burden borne by taxpayers. These states may unilaterally broaden the scope of circumstances in which they are allowed to tax by creating new scenarios that either fall outside the scope of tax treaties or require the application of treaty articles that are more favourable to these states. Conversely, contracting states may also attract foreign investment by allowing the application of tax treaty benefits to taxpayers in situations where these benefits would normally be denied. Despite not violating the literal wording of tax treaties, this state practice may be considered illegitimate based on rules in public international law rules that spell out the correct standards and good usage of treaties.

This book presents new insights on the way contracting states interfere in the interpretation and application of tax treaties by identifying, categorizing and assessing the different methods used by states to modify the outcome of tax treaties. It investigates the tools offered by public international law to affected taxpayers and treaty partners and recommends ways to better address this phenomenon.

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Abstract

In the same way that taxpayers can make use of business arrangements that manoeuvre through the loopholes of legal and treaty provisions for the purpose of reducing tax liability, contracting states may also exercise sovereign rights within "tax treaty gap" areas in a manner that modifies the outcome of these agreements to their own benefit. Through legislative and executive actions (or omissions), contracting states can circumvent obstacles or artificially stretch advantages in a way that complies with the wording of tax treaties but that, ultimately, impacts the allocation of taxing rights and the tax burden borne by taxpayers. These actions and omissions unilaterally broaden the scope of circumstances in which contracting states are allowed to tax by creating new scenarios that either fall outside the scope of tax treaties or require the application of treaty articles that are more favourable to these states. Conversely, contracting states may also attract foreign investment and consequently obtain economic advantages by allowing the application of tax treaty benefits to taxpayers in scenarios when these benefits would normally be denied. Despite conforming to the literal wording of tax treaties, this practice can be considered illegitimate based on international law rules that dictate the correct standards and guide the interpretation and application of treaties. In such case, these illegitimate actions and omissions amount to an improper use of tax treaties by contracting states, or "tax treaty dodging", as defined by the author. The elements derived from the legal bases limiting tax treaty dodging offer guidance for interpreters in assessing how far contracting states may exercise their sovereign rights under international law so that legitimate exercise of rights can be more clearly demarcated from the improper use of the treaty by contracting states. Affected contracting states and taxpayers should make better use of the tools currently available under international law, varying from preventive measures against this practice to financial reparation for damages caused. To assist affected parties, the current study submits a clearer definition of the "improper use of tax treaties by contracting states" (i.e. tax treaty dodging) and recommends ways to better address the phenomenon.

Chapter 1

Introduction

1.1. Aim and scope of the study

In past years, discussions on different types of legal arrangements designed by taxpayers seeking tax avoidance have occupied an increasingly large space in literature and have dominated the debate among academics and practitioners, more recently, in view of the OECD/G20 BEPS Project. Most countries have developed extensive legislation and case law with the purpose of combating such behaviour. In contrast, not much has been said on how contracting states can operate in a similar way. If, on the one hand, the goal of decreasing the global tax liability may lead taxpayers to make use of abusive practices, contracting states may also seek to increase their tax revenue by unilaterally broadening the scope of circumstances in which they are allowed to tax under tax treaties. It is possible that as much as taxpayers can design different types of legal arrangements in conformity with the requirements of law, but with the view of avoiding taxes, contracting states may also be able to impact the application of treaties and extend the advantages for their own benefit, without breaching the wording of such agreements. The analysis of this possibility, which will be referred to throughout this work as (according to Vogel's terminology) tax treaty dodging, is the core of this study.

This book proposes new insights into the way contracting states interfere in the interpretation and application of tax treaties. It intends to demonstrate how the exercise of rights by contracting states may, under certain circumstances, interfere in the application of signed tax treaties. Furthermore, the book seeks to assess whether this behaviour could be regarded as an illegitimate[1] practice as understood by the tax community, i.e. in conformity with the wording of written legal rules but not in accordance with

1. Within this context, term will be defined as "not in accordance with accepted standards of what is right" (*illegitimate*, in *Collins Dictionary*, available at https://www.collinsdictionary.com/dictionary/english/illegitimate (accessed 13 May 2021)) or "not authorized by good usage" (in *Merriam-Webster Dictionary*, available at https://www.merriam-webster.com/dictionary/illegitimate (accessed 13 May 2021)), i.e. in conformity with the legal text it relates to but not in accordance with other accepted principles that echo the correct standards and guide the good usage of that legal text. *See also infra* n. 2.

accepted principles governing the good usage of such written legal rules.[2] If the answer to this is yes, the study will aim to (i) determine the extent to which the methods used by contracting states may be regarded as illegitimate actions; and, thus, (ii) identify elements on the basis of which a clearer dividing line can be drawn between what is considered a legitimate exercise of rights and an illegitimate practice, i.e. tax treaty dodging.

This aim is achieved on the basis of a three-phase analysis, namely (i) the identification of the phenomenon (i.e. observation of the phenomenon, its origins, how it operates and its effects); (ii) a legal assessment of the phenomenon (i.e. whether the phenomenon could be considered condemnable from the perspective of international law – that is, illegitimate – and, if yes, to what extent it would be considered condemnable); and, finally, (iii) the way forward (i.e. identification of the measures available to damaged parties and recommendations to better address the phenomenon).

Part 1 of this study starts from the identification of the phenomenon and the assessment of the different ways in which contracting states are able to impact the effects of signed tax treaties without directly breaching their wording. It detects the two conditions for the phenomenon to exist and derives from this the scenario in which tax treaties become vulnerable to such practice. From the competent authorities that exercise the jurisdictional competences of a state (legislative, administrative and judicial) to the way these competences are exercised in practice, the study deduces the possible types of tax treaty dodging and identifies potential cases where contracting states exercising jurisdictional competences in scenarios vulnerable to tax treaty dodging seem to make use of these opportunities. On the basis of an inductive methodology, the study further identifies, from the potential cases observed, the methods by which contracting states may exercise tax treaty dodging. This part is concluded with the acknowledgement of the consequences of the phenomenon and identification of the affected parties.

2. Although this specific understanding of "legitimate"/"illegitimate" (as opposed to "legal"/"illegal") is not commonly used in the public international law field, the international tax community commonly adopts this understanding of the terms when referring to actions that are in conformity with the text of written legal rules, such as laws and treaties (i.e. those being "legal"), but that are not in line with more general principles or even morality (i.e. those being "illegitimate" and, therefore, legal but illegitimate). This understanding of illegitimacy is commonly used by tax practitioners for tax avoidance actions or for abusive tax planning (either for supporting taxpayers' actions on the basis of its legality or for condemning such actions as illegitimate on the basis of principles of law). The term "illegitimate" will be used in this book with this special connotation.

Part 2 of the study shifts from a factual analysis to a legal analysis stage by placing the phenomenon of tax treaty dodging into the legal scenario, with the aim to answer the research question of this book (section 1.3.). It assesses the phenomenon from the perspective of international law to verify whether this practice could qualify as illegitimate behaviour. This assessment is based on legal sources of international law governing the relation between sovereign states. The identification of possible legal limitations to their exercise of rights also allows for the determination of elements that indicate the extent to which these states may act without overstepping such limitations.

In Part 3, the study seeks to identify, under international and tax treaty law, the measures currently available for the two parties affected by tax treaty dodging and finalizes by proposing a definition for tax treaty dodging and recommending ways to better address this phenomenon.

Finally, the author has noted that this study focuses on the ways in which contracting states may exercise their rights in a way to impact the outcome of treaties and, therefore, only covers actions (or omissions) that are allowed or not forbidden by the wording of these agreements. Consequently, situations where contracting states act in contradiction with the text of tax treaties are not covered in this book.

1.2. Relevance and originality of the study

As of the time of publication, there is no comprehensive academic study on tax treaty dodging. Its rationale has been mentioned in relatively few discussions and mainly as a side subject. The topic was presented in a brief, but more comprehensive, way by Vogel. However, his discussions do not cover all the aspects necessary for a proper understanding of the subject. This book is the first attempt to study this phenomenon in a comprehensive manner by (i) describing the main elements of the mechanism; (ii) identifying the different types of tax treaty dodging and the methods used; and (iii) analysing possible legal limitations and measures available to affected parties.

The author also presents a number of relevant examples and case law worldwide involving possible dodging practices by contracting states in connection with tax treaties. These cases are categorized according to common elements identified by the author in order to illustrate the different tax treaty dodging methods applied by contracting states. The presentation of such a collection is hopefully a significant contribution to the academic literature

not only because of the disclosure of few relatively unknown cases – which necessarily happens in many research projects – but also because the analysis of such cases and of those already widely discussed in the literature is herein made from a different perspective: one of tax treaty dodging.

This different perspective is also used when analysing the interaction between domestic rules and tax treaties. For instance, the relationship between domestic anti-avoidance rules and tax treaties commonly leads to the core question of whether or not a treaty override exists. This book offers a new way of approaching and understanding this interaction and proposes a possible alternative answer to this question. Furthermore, this study also innovates in the tax treaty law field by suggesting the use of preventive and compensatory measures available under public international law and proposing ideas to address the phenomenon in a more efficient manner.

It is of the author's belief that this work, by drawing attention to the subtle methods used by treaty partners (and possibly ignored by the tax community), could contribute to a better understanding of the different ways in which contracting states may interfere in the application of tax treaties.

1.3. Research question

This study addresses the following research question: On what legal basis can the exercise of rights by contracting states, while conforming to the wording of tax treaties but impacting the outcome of such agreements to the states' own benefit, qualify as an illegitimate[3] act? This question entails the following sub-question: If such legal basis exists, where is the dividing line between a legitimate exercise of rights by contracting states and such illegitimate acts under international law?

1.4. Methodology

For the purposes of this study, it was sufficient to appreciate the problem in principle and then to demonstrate and catalogue the most common methods of tax treaty dodging. As such, the author made use of the deductive and inductive methodologies as follows.

3. *See supra* n. 1 and n. 2.

The deductive methodology was used in all parts of this research. On the basis of the analysis of fundamental principles of international law, the author first considered the possible ways in which contracting states may exercise their rights under tax treaties and then, from this analysis, derived the scenarios vulnerable to tax treaty dodging. The types of tax treaty dodging were also concluded on the basis of the competent authorities that exercise the legislative, administrative and judicial competences under state jurisdiction and how they exercise this competence in respect of tax treaties. This methodology was also widely used in Part 2 of the research, where the author identified possible limits to the exercise of rights by contracting states through the analysis of available international legal sources and fundamental theories. This analysis yielded a conclusion on whether (and to what extent) these sources and theories may also serve as a legal basis to limit the occurrence of tax treaty dodging.

The inductive methodology was broadly used in Part 1 of the study. The identification and analysis of selected cases and international case law allowed for the detection and categorization of common elements identified by the author in order to illustrate the different methods of tax treaty dodging. A complete overview of all global cases is beyond the scope and means of this study. For this reason, the inductive methodology used in this book to identify the methods of tax treaty has the unfortunate downside of preventing other possible existing methods of tax treaty dodging from being identified.

1.5. Structure of the book

This study consists of six chapters (including this introduction as chapter 1) as follows:

Chapter 1 presents the aim and scope of the study and explains the relevance and originality of the topic chosen. It introduces the research question of this book and the methodology followed by the author, as well as the structure of this study.

Part 1 – The Phenomenon of Tax Treaty Dodging

Chapter 2 presents the phenomenon of tax treaty dodging as the exercise of rights by contracting states, while in conformity with the wording of tax treaties, that interferes in the application of these agreements to the benefit of these states. The chapter explains (i) its origins; (ii) how the phenomenon

was observed and debated in literature throughout past decades; and (iii) the reasons for labelling the phenomenon "tax treaty dodging".

Chapter 3 delimits the scenarios in which treaty dodging is possible by identifying the conditions of the phenomenon. The chapter describes how the tax treaty gaps, together with the ambulatory interpretation, open doors to dodging practices. Following the analysis (using the inductive methodology) of potential tax treaty dodging cases, the author proposes the categorization of the phenomenon into types of tax treaty dodging and the different methods through which it can be implemented. The chapter concludes the factual analysis stage necessary for the overview of the phenomenon by detecting the consequences for treaty partners and taxpayers.

Part 2 – The Legal Assessment of Tax Treaty Dodging

Chapter 4 initiates the legal analysis phase of this study by addressing the research question of whether (and on which legal basis) tax treaty dodging could be regarded as illegitimate behaviour. The answer to this first question provides the elements necessary for answering the sub-question of how to identify the dividing line between the legitimate exercise of rights by contracting states under tax treaties and tax treaty dodging. The chapter finalizes by indicating the reasons for differentiating between tax treaty dodging and actions that violate the wording of tax treaties.

Part 3 – The Way Forward: Addressing Tax Treaty Dodging

Chapter 5 investigates measures currently available under international and tax treaty law to assist affected treaty partners and taxpayers.

Chapter 6 summarizes the main conclusions of this book, proposes a definition for tax treaty dodging and recommends ways to better address this phenomenon.

Chapter 2

The Genesis of the Phenomenon

2.1. Introduction

The violation of treaties is not a recent subject. It has been discussed and analysed by public international law scholars and practitioners for several decades. One type of infringement that is of particular interest to the international tax community is the enactment of domestic tax legislation in violation of provisions in existing tax treaties. However, there are more subtle ways for contracting states to interfere with the application of tax treaties – so subtle to the point that any possible violation of the treaty will not be obvious or easy to assess. These attempts are not in conflict with the text of treaty provisions, but lead to effects similar to those contradicting the wording of the treaty.[4] As a consequence, it is not clear whether they could legally constitute an actual infringement of the treaty. For example, this may be the case when a contracting state redefines the nature of a charge from income tax to a type of contribution so that this levy is no longer covered by a tax treaty (and, consequently, no longer limited by this agreement). Additionally, this could occur when a contracting state makes use of its right to define a certain treaty term in order to broaden its treaty taxing rights by artificially including unusual items, such as in the case of defining immovable property to include gambling machines and, consequently, triggering taxing rights over the related income according to the treaty rules. These contracting states' actions (or omissions, as will be discussed in section 3.3.1.1.) follow a certain pattern, i.e. complying with the wording of tax treaties by making use of tax treaty gaps, but having an unexpected impact on the outcome of these agreements to the benefit of such states. This occurrence is observed by the author and introduced in Part 1 of this book as the phenomenon[5] of tax treaty dodging.[6]

4. Contracting states' actions qualified in this book as "tax treaty dodging" should be distinguished from acts that violate the wording of a treaty. Whether both or only the latter are qualified as tax treaty override is a matter of the scope of the concept of tax treaty override that is used by the interpreter; *see* details in sec. 4.4.

5. A "phenomenon" is generally defined as an observable fact or event. Modern philosophers have used the term "phenomenon" to designate what is apprehended before a judgment is applied (*Phenomenon*, in *Concise Oxford English Dictionary*, 11th ed. and *Columbia Electronic Encyclopedia*.

6. The reasons for labelling the phenomenon (and labelling it "tax treaty dodging") are explained in sec. 2.4.

The legal aspects of the phenomenon are not analysed in Part 1 of this book; the analysis and assessment of tax treaty dodging from the perspective of international law are only presented in Part 2. Part 1 aims to detect the existence of a particular event that affects the application of tax treaties, irrespective of its legal nature and regardless of the legal aspects involved. It simply apprehends a fact before a judgment is applied. For this purpose, this chapter initiates the first of the three-step analytical process indicated in chapter 1 by identifying the phenomenon of tax treaty dodging and its origins. The author considers that the observation of the background and the way the phenomenon has been spotted by scholars is an important and necessary step for the appropriate analysis developed in the following chapters of this book.

This chapter starts by presenting, in section 2.2., the roots of the phenomenon of tax treaty dodging. It shows how the dodging mechanism emerged as an alternative solution for countries, on the one hand, facing inconvenient effects of signed tax treaties and, on the other, being reluctant to directly override treaty provisions. The basic aspects of the dodging mechanism will become evident in that section, and the reader will be introduced to how the "non-self-sufficiency"[7] of tax treaties plays a decisive role in this respect. Section 2.3. travels back in time to show how the phenomenon of tax treaty dodging has been discussed in literature throughout the decades and how opposing views and different understandings within the debate have prevented the development of a coherent and systematic theory on tax treaty dodging today. Also, no expression has been used in literature in a consistent manner to the point of becoming the common designation of the phenomenon, but labelling the phenomenon as "tax treaty dodging" has its advantages, as explained in section 2.4.

2.2. The origins of the phenomenon

2.2.1. The need for a subtle "backdoor" alternative for opportunistic countries

The first step towards a systematic understanding of a phenomenon is the investigation of the reasons behind its existence. In this sense, the

7. "Non-self-sufficiency" in the sense that tax treaties are generally not able to provide all elements necessary for their own application and, therefore, need to be supplemented by other rules normally existing in domestic law; *see* details in sec. 2.2.2. and sec. 3.2.1.

phenomenon of tax treaty dodging seems to emerge as an alternative solution for contracting states facing the dilemma of having to either (i) bear the inconvenient effects, whenever they exist, of signed tax treaties; (ii) tolerate the time-consuming process of renegotiation; or (iii) directly override these signed agreements and, consequently, face international repercussions and sanctions. This frustrating dilemma may encourage contracting states to explore other, more convenient alternatives for solving the problem, such as mitigating the undesired effects of signed tax treaties without being noticed or blamed for having breached treaty provisions.

The violation of a treaty provision may take different forms. One form is through legislature or judicial actions, such as in the case of the enactment of domestic legislation or the issue of a court decision that is in clear contradiction with treaty provisions. It may also consist of actions of a more executive nature, as in the case of a state declining to surrender an alleged criminal to another state pursuant to an extradition treaty between them that covers the alleged crime.[8]

From a more traditional and theoretical public international law perspective, the possibility of a violation of a treaty provision through legislation or, to a certain extent,[9] judicial and executive actions is intrinsically connected with the fundamental theories of the relationship between international law and national law, namely (i) the dualist theory, first systematically developed in the absolutist thoughts of Triepel and Anzilotti;[10] and (ii) the monist theory, defended by a number of scholars with theories that diverge significantly, but having its most representative support in the ideas of Kelsen, Scelle and Lauterpacht.[11]

8. *See*, for example, A.D. McNair, *The Law of Treaties* p. 540 (Oxford University Press 1961).

9. To the extent that they are related to the application of domestic legislation.

10. Triepel was the first to present a systematic study on dualism in C.H. Triepel, *Völkerrecht und Landesrecht* (CL Hirschfeld 1899). The French version, which was used for the purposed of this book, is H. Triepel, *Droit International et Droit Interne* (Panthéon-Assas 2010). His theory was later adapted and completed by Anzilotti in D. Anzilotti, *Il Diritto Internazionale nei Giudizi Interni* (Ditta Nicola Zanichelli 1905).

11. Kelsen defends monism on formalistic logical grounds (*see* H. Kelsen, *General Theory of Law & State* pp. 363-383 (Transaction Publishers 2006); H. Kelsen, *Principles of International Law* pp. 401-447 (Rinehart & Company 1952); and H. Kelsen, *Pure Theory of Law* pp. 328-347 (University of California Press 1970), while Lauterpacht upholds a strong ethical position with a deep concern for human rights.

The dualist (or pluralist)[12] theory, inspired by the 19th-century Hegelian conjectures on the glorification of the state and its sovereignty,[13] provides that, since international and national law have different sources, address different subjects of international law and rule on different relations,[14] they are completely distinct, self-contained legal orders that coexist but never intersect.[15] In this sense, conflicting international and national provisions do

12. The systems under consideration in the dualist theory are actually the international system and the several national legal systems, leading to the conclusion that a "pluralist" conception would be more appropriate than a "dualist" conception. However, most international law scholars refer to dualism as a simplified version of pluralism. *See*, e.g. G. Arangio-Ruiz, *International Law and Interindividual Law*, in *New Perspectives on the Divide between National & International Law* p. 17 (J. Nijman & A. Nollkaemper eds., Oxford University Press 2007); Kelsen (1952), id., at p. 404; Kelsen (2006), id., at p. 363; and G. Gaja, *Dualism – a Review*, in *New Perspectives on the Divide between National & International Law* p. 53 (J. Nijman & A. Nollkaemper eds., Oxford University Press 2007).

13. Hegel was a German post-Kantian philosopher who defended a state-centered perception of international law in which sovereignty is understood as absolute independence and freedom and states are "perfectly independent totalities" with the "realization of freedom". *See* M. Isenbaert, *EC Law and the Sovereignty of the Member States in Direct Taxation* p. 51 (IBFD 2008), Books IBFD. On the importance of Hegel's doctrine for international law, *see* Anzilotti, *supra* n. 10, at pp. 12-20 and 27 and footnotes.

14. According to dualists, international law regulates the conduct of states as a subject of international law and, therefore, interstate relations, while national law applies to the relationship between state organs and individuals and amongst individuals. In addition, international law is based on the collective will of states (customs and treaties), while national law is based on the unilateral will of a state (law). *See* Triepel, *supra* n. 10, at pp. 11-13. There are several criticisms of these assumptions, such as the one defending that current international law does not appear to make a distinction on the basis of legal subjects, since international law may also govern the relations between states and individuals and create rights and obligations for individuals (*see* Gaja, *supra* n. 13, at p. 56). For other criticisms, *see* Kelsen (1952), *supra* n. 11, at pp. 404-419; and Kelsen (2006), *supra* n. 11, at pp. 364-368.

15. Triepel, *supra* n. 10, at pp. 11-12 and 252; Kelsen (1952), *supra* n. 11, at pp. 403-404; Kelsen (2005), *supra* n. 11, at pp. 363-364; G. Fitzmaurice, *The General Principles of International Law Considered from the Standpoint of the Rule of Law* p. 70 (The Hague Academy of International Law 1957); I. Brownlie, *Principles of Public International Law* pp. 31-32 (Oxford University Press 2008); D. Nguyen Quoc, P. Daillier & A. Pellet, *Droit International Public* pp. 86-87 (Librairie Générale de Droit et de Jurisprudence 1987); M.N. Shaw, *International Law* p. 131 (Cambridge University Press 2008); A. Aust, *Modern Treaty Law and Practice* pp. 151-152 (Cambridge University Press 2000); M. Dixon, *Text Book on International Law* p. 89 (Oxford University Press 2007); E. Denza, *The Relationship between International and National Law*, in *International Law* pp. 428-429 (M. Evans ed., Oxford University Press 2006); Gaja, *supra* n. 12, at pp. 52-54; M.P. Brichambaut, J-F. Dobelle & M-R. D'Haussy, *Leçons de Droit International Public* p. 180 (Presses de Sciences PO et Dalloz 2002); and H. Accioly, G.E.N. Silva & P.B. Casella, *Manual de Direito Internacional Público* p. 211 (Saraiva 2009).

not affect the validity of each other,[16] and neither legal order has the power to create or alter the rules of the other.[17] As a consequence of this divide, international law needs to be transformed into national law in order to be applicable in the national legal order. Once international law, such as a tax treaty, is transformed, it receives the status of a national law, which can be amended or repealed by subsequent national legislation in the same hierarchy level (*lex posterior derogat priori*).[18] The fact that the international law transformed and inserted into the national legal order does not, in general,[19] prevail over national legislation and may be overruled by it under the *lex posterior derogat priori* rule makes treaty override a possible and legitimate occurrence within the dualist system. This means that if an amendment or repeal internationally results in a treaty breach, there will be no remedy in domestic law, since there is no violation of it.[20]

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16. According to Triepel, *supra* n. 10, p. 252, "it is thus impossible that a principle in one of the juridical systems conflicts with a principle in the other system".
17. Brownlie, *supra* n. 15, at p. 32.
18. It is interesting to observe that this rule has some reservations when it comes to tax treaties. A relevant number of scholars argue that these agreements are special legislation (*leges speciales*) – as they are restricted to the cross-border taxation of residents of the contracting states – and, thus, cannot be affected by subsequent changes to general domestic law (*lex generalis*) as a result of the *lex posterior generalis non derogat legi priori speciali* rule. Only if the legislature states its intention to override a tax treaty could general domestic legislation derogate from tax treaty provisions. According to Vogel, "under a supplementary rule of 'Lex posterior generalis non derogat legi priori speciali' ('later general legislation does not overrule earlier special legislation'), changes of domestic tax law normally will not affect existing treaties" (K. Vogel, *The Domestic Law Perspective*, in *Tax Treaties and Domestic Law* p. 3 (G. Maisto ed., IBFD 2006), Books IBFD). Similarly, Sasseville says that "the principle that a more specialized enactment prevails over a more general one ('*lex specialis derogat legi generali*') is more likely to ensure the priority of tax treaty provisions than the principle that a later provision prevails over an old one" (J. Sasseville, *A Tax Treaty Perspective: Special Issues*, in *Tax Treaties and Domestic Law* p. 42 (G. Maisto ed., IBFD 2006), Books IBFD). *See also* K. Vogel & R.G. Prokisch, *Interpretation of double taxation conventions – General Report* p. 59, IFA Cahiers de Droit Fiscal International vol. 78a (Kluwer 1993); A. Rust, *Germany*, in *Tax Treaties and Domestic Law* pp. 235 and 238 (G. Maisto ed., IBFD 2006), Books IBFD; D. Hohenwarter, *Austria*, in *Tax Treaties and Domestic Law* pp. 169-171 (G. Maisto ed., IBFD 2006), Books IBFD; P. Bracco, *Italy*, in *Tax Treaties and Domestic Law* p. 254 (G. Maisto ed., IBFD 2006), Books IBFD; and H. Tôrres, *Pluritributação Internacional sobre as Rendas de Empresas* pp. 593-594 (Revista dos Tribunais 2001). *See also* BR: STJ, 17 May 2012, RE 1.161.467, RS *Copesul – CIA/ Petroquímica do Sul*, Case Law IBFD in the sense that tax treaties are special law and, thus, prevail over general posterior domestic law.
19. The non-application of national law in view of the supremacy of international law within a dualist system may only result from a rule pertaining to the national legal order, such as those which can be found in many constitutional provisions that require compliance with international law. This supremacy can only be achieved as far as the constitutional provision goes, since this result could be reversed by a future change in the national constitutional law (*see* Gaja, *supra* n. 12, at p. 61).
20. Aust, *supra* n. 15, at p. 151.

In contrast, the monist theory is rooted in the reactive ideas of the liberation of the individual in the early 20th century and generally defends the view that international and national law are part of one single legal order.[21] Under this theory, international law is automatically applicable at the national level, without the need for transformation into national law. Since they both belong to the same legal order, a conflict of norms may arise, resulting in the necessary primacy of one over the other. For one segment of the monist theory that sees international law as a mere external public law of the state (state monism, today abandoned by most monist scholars), internal law prevails over international law.[22] In contrast, the other, more representative segment of monism (internationalist monism), supported by sociological objectivist scholars like Scelle and by the founders of the Viennese School of Jurisprudence,[23] advocates the superiority of international law.[24] For this

21. Kelsen (1952), *supra* n. 11, at pp. 424-428; Kelsen (2006), *supra* n. 11, at p. 373; Fitzmaurice, *supra* n. 15, at p. 70; Brownlie, *supra* n. 15, at p. 32; Nguyen Quoc, Daillier & Pellet, *supra* n. 15, at pp. 86-87; Shaw, *supra* n. 15, at pp. 131-132; Aust, *supra* n. 16, at p. 146; Dixon, *supra* n. 15, at p. 88; Denza, *supra* n. 15, at p. 428; Brichambaut, Dobelle & D'Haussy, *supra* n. 15, at p. 181; and Accioly, Silva & Casella, *supra* n. 15, at p. 211.

22. Nguyen Quoc, Daillier & Pellet, *supra* n. 15, at p. 88.

23. Vendross and Kunz hold a stronger position than Kelsen on the superiority of international law. For Vendross and Kunz, the departing point is inevitably the principle of the superiority of international law, since the various states do not dispose of sovereignty in its full sense, while Kelsen, after revisiting his initial position on the supremacy of international law expressed in the first edition of *Reine Rechtslehre* understood that the problem did not have an imperative solution and expressed a more moderate view by arguing that one could support the supremacy of either international law or national law: "[T]he Pure Theory of Law opens the road to either the one or the other political development, without postulating or justifying either, because as a theory, the Pure Theory of Law is indifferent to both" (*see* Kelsen (1970), *supra* n. 11, at p. 347). *See also* the comments by M. J. Ellis in B. J. Arnold et al., *Round Table: Improving the Relationships Between Tax Treaties and Domestic Law*, in *Tax Treaties and Domestic Law* (G. Maisto ed., IBFD 2006), Books IBFD; Nguyen Quoc, Daillier & Pellet, *supra* n. 15, at pp. 72 and 88-89; and Accioly, Silva & Casella, *supra* n. 15, at p. 211.

24. For Scelle, "any intersocial norm takes precedence over any internal norm in contradiction with it, modifies or abrogates it *ipso facto*" (*see* Nguyen Quoc, Daillier & Pellet, *supra* n. 15, at p. 89). Kelsen expresses that the legality of one norm is derived from an anterior, more general and superior rule and that referral to the previous rule leads to the ultimate or basic norm (*Grundnorm*); *see* Kelsen (1952), *supra* n. 11, at pp. 408-415. For him, "it is the basic norm of international legal order which is the ultimate reason of validity of the national legal orders, too". However, he later admits his basic norm as a hypothesis based on assumptions, since the mandatory nature of international custom could not be proven, and that the primacy of international law can only be decided on the basis of non-strictly legal considerations: "Both systems are equally correct and equally justified. It is impossible to decide between them on the basis of the science of law. ... It can be made only on the basis of nonscientific, political considerations." (*See* Kelsen (1970), *supra* n. 11, at p. 346.) *See also* the sources cited in id.; Nguyen Quoc, Daillier & Pellet, *supra* n. 15, at p. 94; and Brownlie, *supra* n. 15, at p. 33. Lauterpacht also

major segment, treaty override by domestic law is not possible or legitimate.[25]

Under the dualist theory and the state monist theory, contracting states facing inconveniences in respect of an international agreement would have the possibility to have this problem solved through a direct override. Thus, in theory, no alternative solution would necessarily need to be explored. Internationalist monist countries, on the other hand, would not be able to legitimately override treaty provisions through the enactment and application of conflicting domestic legislation. At the same time, the process of the renegotiation of a treaty may be perceived as being too time-consuming to offer a viable method of resolving this problem.[26] How would they counter the undesired effects of a signed treaty? This was one of the points raised by Ellis when detecting this deadlock situation in a monist country like the Netherlands: "[H]ow does a monist country override tax treaties? That is the puzzle that faces our legislature, i.e. when our legislators and government are faced with treaty provisions that, in their view, have undesired effects and should be changed."[27]

Ellis concluded that in these situations, a monist country cannot override tax treaties through the "front door".[28] In fact, as explained here, front door override is, in theory, incompatible with the internationalist monist system. The undesired effects of signed treaties would have to be accepted by those countries unless a compatible alternative solution could be found that mitigates the undesired effects of tax treaties but is implemented in a way to arguably avoid a clash within the monist structure. This compatible

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recognizes that the supremacy of international law is the best way to fulfil the primary function of law, which is ensuring the well-being of individuals (*see* Shaw, *supra* n. 15, at pp. 131-132; and Dixon, *supra* n. 15, at p. 88).

25. The fact that courts and legislatures of certain monist countries may not, in practice, behave in accordance with these rules does not invalidate the theory, but only indicates the weakness of international law (*see* Denza, *supra* n. 15, at p. 428).

26. M. Rigby, *A Critique of Double Tax Treaties as a Jurisdictional Coordination Mechanism*, 8 Australian Tax Forum 3, p. 385 (1991). Rigby also recalls that the OECD recognizes that treaty negotiations may be time-consuming but that this cannot justify treaty override (p. 406). The same remark is made by D. Lüthi, *Consequences of Conflicts between International Treaty Law and International Law*, in *Tax Treaties and Domestic Legislation* p. 9 (Kluwer 1991). This puts even greater pressure on states to find an alternative solution.

27. Comments by M.J. Ellis in B.J. Arnold et al., *Round Table: Improving the Relationships Between Tax Treaties and Domestic Law*, in *Tax Treaties and Domestic Law* p. 393 (G. Maisto ed., IBFD 2006), Books IBFD.

28. Id., at p. 394.

alternative solution would be so subtle to the point that its possible illegitimacy or incompatibility with the internationalist monist theory, if at all, would be difficult to detect or assess.

That seems to be the point Ellis makes when he lists attempts that he calls "backdoor overrides". These attempts, implemented though the "backdoor", represent alternative solutions that would nullify the inconveniences of signed tax treaties without a direct violation of their provisions: on the contrary, they would be formally in line with the wording of these agreements to the point that they would simply "work through into the treaties".[29]

The analysis presented here of the need for a subtle backdoor alternative is performed from a more traditional and theoretical public international law perspective on the relationship between international and national law, based on the dichotomy between monism and dualism. However, a considerable number of international law scholars have been adopting a more pragmatic view on the subject in recent years. This more pragmatic view, which is dominant today, is that reality is not in conformity with either monism or dualism and that taking a concrete look at practice is a more appropriate way to understand the relationship between international and national law.[30] Modern scholarship has become pragmatic, inductive and

29. Id.

30. Brownlie, *supra* n. 15, at pp. 33-34; Denza, *supra* n. 15, at p. 429; Shaw, *supra* n. 15, at pp. 132-133; Dixon, *supra* n. 15, at pp. 90-91; B. Conforti, *Diritto Internazionale* p. 308 (Editoriale Scientifica 2010); V.S. Vereshchetin, *Some Reflections on the Relationship Between International Law and National Law in the Light of the New Constitutions*, in *Constitutional Reform and International Law in Central and Eastern Europe* pp. 6-7 (R. Müllerson, M. Fitzmaurice & M. Andenas eds., Kluwer International Law 1998); and J. Nijman & A. Nollkaemper, *Introduction*, in *New Perspectives on the Divide between National & International Law* pp. 2-3 (J. Nijman & A. Nollkaemper eds., Oxford University Press 2007). The opinions on the relevance of the traditional theories for understanding the relationship between international and national law vary among scholars, ranging from a more radical view, like those of Fitzmaurice (with his theory of the absence of a common field: "[A] radical view of the whole subject may be propounded to the effect that the entire monist-dualist controversy is unreal, artificial and strictly beside the point, because it assumes something that has to exist for there to be any controversy at all – and which in fact does not exist – namely a common field in which the two legal orders under discussion both simultaneously have their spheres of activity"; *see* Fitzmaurice, *supra* n. 15, at p. 71) and Denza ("the theories are not useful"; *see* Denza, *supra* n. 15, at p. 429) to more cautious opinions. As an example, Nijman & Nollkaemper, cited in this footnote above, at pp. 2-3 and 10-12 detect this trend, but propose the development of a new perspective grounded in practice, recognizing the importance of a more conceptual and normative perception of this evolution, and adapt modern developments, such as globalization, the emergence of common values and the dispersion of authority over different public and private actors.

Notes

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