

# The Interpretation of Tax Treaties: Looking to the Future

**The thesis of this article is that, for a variety of reasons, national courts often make fundamental mistakes in deciding tax treaty cases. To address this problem, the article suggests a process for tax treaty experts to provide advisory to national courts on tax treaty issues.**

## 1. Introduction

The thesis of this brief article is that the interpretation and application of the provisions of bilateral tax treaties by national courts could be significantly improved through the establishment of an international body to provide independent expert advisory opinions in tax treaty cases. The article begins by examining the guidance that is available to national courts with respect to the interpretation of tax treaties (*see* section 2.). It argues that this guidance is inadequate and contributes to decisions about tax treaties that are often inconsistent – and sometimes simply wrong – and that some type of international mechanism is needed to address the problem (*see* sections 3. and 4.). The article then suggests that it would be useful to consider establishing a process for tax treaty experts to provide advisory opinions to national courts on cases involving the interpretation of tax treaties (*see* section 5.). Finally, the article briefly discusses how such a process might be structured.

This article does not deal with the proper approach to the interpretation of tax treaties,<sup>1</sup> a comparison of statutory interpretation and treaty interpretation or specific aspects of the interpretation of tax treaties, such as the effect of article 3(2) of the OECD Model,<sup>2</sup> the role of the OECD Commentaries or the influence of the interpretive rules of the Vienna Convention on the Law of Treaties (the “Vienna Convention”)(1969).<sup>3</sup> Instead, the article focusses on an assessment of how national courts around the world have *actually* interpreted tax treaties and whether the guidance provided to national courts with respect to the interpretation of tax treaties is adequate. This assess-

ment leads to the conclusion that national courts, even the courts of the most highly developed countries, have not generally performed well in interpreting tax treaties; fundamental mistakes occur frequently, revealing a basic misunderstanding of how tax treaties are intended to operate. The result, I argue, is a growing body of jurisprudence that is inconsistent, inaccurate and unreliable.

What, if anything, can be done to address this situation and improve the quality and consistency of national court decisions involving tax treaties?

## 2. Guidance with Respect to the Interpretation of Tax Treaties

### 2.1. Introductory remarks

This section of the article reviews the guidance that is available for national courts to consult in interpreting tax treaties.

### 2.2. The Vienna Convention on the Law of Treaties

The interpretation of treaties, including tax treaties, is governed by the rules in articles 31 to 33 of the Vienna Convention. The basic interpretive rule in article 31(1) provides:

A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

The other provisions of article 31 provide some elaboration of the meaning of “context,” the materials that should be considered in addition to the context, and the need to give certain terms of a treaty a special meaning rather than their ordinary meaning. Article 32 limits, but does not exclude, consideration of “supplementary materials” in interpreting a treaty (i.e. any material not covered by article 31(1) to confirm the meaning obtained by applying article 31 or to establish the meaning of a treaty provision where the meaning, after applying article 31, is “ambiguous or obscure” or the result is “manifestly absurd or unreasonable”). Article 33 establishes rules for the interpretation of treaties concluded in multiple official languages.

As I have written previously (and I have not changed my mind), the interpretive rules of the Vienna Convention are self-evident and too vague to be of practical assistance to judges in deciding the appropriate meaning to be given to the provisions of a treaty.<sup>4</sup> Article 31 of the Vienna Convention can support any type of interpretive approach, from a narrow literal approach to a broad purposive approach,

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1. There is an immense body of literature about the interpretation of tax treaties. I have written previously in the *Bulletin for International Taxation* about the subject: *see* B.J. Arnold, *The Interpretation of Tax Treaties: Myth and Reality*, 64 Bull. Intl. Taxn. 1, pp. 2-15 (2010), Journal Articles & Opinion Pieces IBFD.  
2. *OECD Model Tax Convention on Income and on Capital*, art. 3(2) (OECD 2017), Treaties & Models IBFD.  
3. *UN Vienna Convention on the Law of Treaties*, vol. 1155, p. 331 (23 May 1969), Treaties & Models IBFD.

4. *See* Arnold, *supra* n. 1, at p. 5.

and including a historical approach and an approach that searches for the intentions of the contracting states.<sup>5</sup> More importantly and crucially, neither article 31 nor article 32 prescribes – and it would be completely inappropriate for the Vienna Convention to attempt to do so – the weight to be given to the text, context or purpose of a treaty (or any other evidence with respect to the meaning of the treaty) in any particular case. Articles 31 and 32 draw a troublesome distinction between authentic and supplementary materials and attempt (ineffectively) to limit the use of supplementary materials; however, they do not limit the weight to be accorded to relevant supplementary material.

As I concluded previously, the interpretive provisions of the Vienna Convention are “largely meaningless” and do not provide meaningful guidance for judges in interpreting tax treaties.<sup>6</sup> Thus, in most tax treaty cases, the interpretive provisions of the Vienna Convention are not mentioned and, even in cases in which the Vienna Convention provisions are cited, they do not appear to have any significant impact on the decisions in those cases.

### 2.3. Commentaries on the OECD and UN Models

Unlike the interpretive provisions of the Vienna Convention, the OECD and UN Commentaries provide meaningful and practical guidance with respect to the interpretation of tax treaties that are based on the provisions of the OECD and UN Models.<sup>7</sup> The provisions of the OECD and UN Models themselves do not provide rules as to how those provisions should be interpreted, with the exception of article 3(2) (undefined terms must be construed in accordance with their meaning under the domestic law of the country applying the treaty unless the context provides otherwise) and article 25(3) (allowing the competent authorities to resolve difficulties or doubts with respect to the interpretation of the treaty). Instead, the Commentaries provide practical guidance as to how the words of the OECD and UN Models should be interpreted and applied in particular factual situations; they provide answers to questions about what the words of a treaty mean, not general approaches to the interpretation of the words of a treaty.

Despite the undeniable importance of the Commentaries in resolving issues with respect to the interpretation of tax treaties,<sup>8</sup> the usefulness of the Commentaries is limited, for several reasons.

First, the Commentaries do not, and cannot, deal comprehensively with all the issues of interpretation that could

5. Art. 31 does not preclude other methods of interpretation not referred to in art. 31. See I. Sinclair, *The Vienna Convention on the Law of Treaties*, p. 120 (2nd ed., Manchester University Press 1984).

6. See Arnold, *supra* n. 1, at p. 8.

7. *OECD Model Tax Convention on Income and on Capital* (OECD 2017), *Treaties & Models* IBFD and *UN Model Double Taxation Convention between Developed and Developing Countries* (UN 2017), *Treaties & Models* IBFD. See H. Ault, *The Role of the OECD Commentaries in the Interpretation of Tax Treaties*, in *Essays in Honor of Sidney I. Roberts* p. 61 (H.H. Alpert and K. van Raad eds., Kluwer 1993).

8. Para. 29.3 *OECD Commentary* asserts that the Commentary has been cited in decisions of the courts “of the great majority of member countries” and “have played a key role in the judges’ deliberations.”

potentially arise with respect to the wording of the provisions of the OECD and UN Models. Thus, the Commentaries may often be silent about many issues of interpretation that end up in court. The Commentaries deal only with the issues of interpretation that the OECD and UN were able to anticipate initially, when the Models were first adopted, or subsequently, when updating the Models and their Commentaries. Although the Commentaries are periodically updated and sometimes deal with issues of interpretation that have arisen in court cases or in the application of tax treaties by tax administrations, it is questionable whether such changes to the Commentaries apply to existing tax treaties or only to tax treaties that are subsequently concluded. The Introduction to the OECD Model indicates clearly that the current version of the Commentary is intended to apply to all tax treaties;<sup>9</sup> however, scholars and courts have taken the position that changes to the Commentary cannot be used to interpret tax treaties entered into before those changes were made.<sup>10</sup> This issue often boils down to whether the changes to the Commentary merely clarified the meaning of the previous version of the Commentary or altered that meaning, a distinction that is difficult to apply in practice and can lead to differing interpretations.

Second, the provisions of the OECD Model are subject to reservations by member countries and the OECD Commentary is subject to member country observations.<sup>11</sup> In addition, several non-member countries that participate as observers in the OECD work on tax treaties have registered their positions on the articles of the OECD Model and on the OECD Commentary.<sup>12</sup> To the extent that a member country has entered reservations or observations on the OECD Model or a non-member country has registered a position contrary to the OECD position, the guidance in the OECD Commentary is not applicable to that country’s tax treaties.<sup>13</sup>

9. Introduction, paras. 33 to 36.1 *OECD Model Convention*.

10. See, for example, M. Lang, *Introduction to the Law of Double Taxation Conventions* pp. 45-48 (Linde (Vienna) 2010 and IBFD (Amsterdam) 2010), *Books* IBFD; D.A. Ward et al., *The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries on the OECD Model* pp. 95-111 (IFA (Canadian Branch) and IBFD 2005). In *Prévost Car Inc. v. The Queen*, 2009 FCA 57 at para. 11, the Federal Court of Appeal of Canada wrote: “The same may be said with respect to later commentaries, when they represent a fair interpretation of the words of the Model Convention and do not conflict with Commentaries in existence at the time a specific treaty was entered and when, of course, neither treaty partner has registered an objection to the new Commentaries.”

11. The *UN Model* is the responsibility of the UN Committee of Experts for International Cooperation in Tax Matters. As a result, country reservations and observations are not allowed. However, the majority and minority views of the members of the Committee on many issues of interpretation are presented in the *UN Commentary*.

12. As of November 2017, 33 countries had registered their positions. Two of these countries, Colombia and Costa Rica, have since become members of the OECD.

13. However, it is useful for a country’s courts to know with clarity that the *OECD Commentary* is not relevant with respect to that country’s tax treaties. In the absence of reservations and observations, it is unclear how courts would know whether to apply the interpretation adopted in the Commentary to a country’s tax treaties. In *IN: SC, 2 Mar. 2021, Engineering Analysis Center of Excellence Private Limited et al. v. Commissioners, Civ. Appeals No. 8733-8734 of 2018*, the Supreme Court of India decided that payments for the use of computer software were not royalties for purposes of several Indian treaties in accordance with para.

Third, the guidance in the Commentaries is clearly not binding on national courts, even the courts of OECD member countries. Indeed, national courts are not even required to consult or consider the Commentaries.<sup>14</sup> Nevertheless, the OECD Commentary is not only regularly considered in tax treaty cases but also often given substantial weight and persuasive value. Overall, the treatment of the OECD Commentary by national courts suffers from considerable inconsistency.

Fourth, it is unclear where the OECD and UN Commentaries fit into articles 31 and 32 of the Vienna Convention. Although, as noted above, in my view, this issue is not very important because the provisions of the Vienna Convention do not preclude national courts from considering and attributing persuasive weight to the Commentary, there is a disproportionately large literature on the issue.<sup>15</sup> Authors differ significantly on whether the Commentaries are supplementary materials under article 32 of the Vienna Convention or are more authentic materials covered by article 31;<sup>16</sup> they appear to assume that the characterization of the Commentaries affects either recourse to the Commentaries by national courts or the weight to be given to the Commentaries by those courts. The courts themselves have not considered this issue to be worthy of much discussion.

Fifth, the Commentaries themselves require interpretation, are sometimes unclear, and sometimes change subtly over time;<sup>17</sup> as a result, in such cases the Commentaries do not provide useful practical guidance for national courts. The Commentary on the concept of “beneficial owner” in several provisions of the OECD and UN Models is a good example of ambiguous commentary that is susceptible to starkly different interpretations.<sup>18</sup> Some commentators

and courts have interpreted the OECD Commentary on the meaning of beneficial owner so that the recipient of an item of income is not treated as the beneficial owner only where the recipient is an agent, nominee or acts as a conduit for another person.<sup>19</sup> In contrast, other commentators and courts have interpreted the same Commentary as requiring beneficial ownership to be treated as a broad anti-avoidance rule using a substance-over-form interpretive approach.<sup>20</sup>

Sixth, some national courts of non-OECD member developing countries may be skeptical about relying on the OECD Commentary because of concerns about the bias of capital-exporting developed countries reflected in the OECD Model and Commentary. Even the courts of OECD member countries may be concerned about relying too much on the OECD Commentary to resolve disputes between taxpayers and the government because the Commentary is prepared by government officials and may reflect self-serving positions.

#### 2.4. Other guidance

National courts may have access to other sources of guidance with respect to the interpretation and application of tax treaties in specific cases. Such guidance includes:

- rules in domestic legislation. These rules are relevant only for countries that require their treaties to be enacted as domestic legislation;<sup>21</sup>
- administrative guidance provided by a country’s tax administration or finance department in the form of taxpayer rulings and other published information, including model treaties;<sup>22</sup>
- foreign court decisions involving tax treaties.<sup>23</sup> Although the national courts of some countries – Australia, Canada, India, New Zealand, the United Kingdom and the United States – occasionally refer to foreign cases, this does not appear to be standard practice in tax treaty cases. In most countries, reference to foreign cases by national courts seems either to be unacceptable or not to be part of the judicial culture; and
- secondary sources. References to well-respected secondary sources (books, loose-leaf services and arti-

example is the *OECD Commentary* dealing with the compatibility of controlled foreign corporation rules and tax treaties.

14 *OECD Commentary on Article 12*, despite an Indian reservation on that paragraph of the *OECD Commentary* and despite the fact that India is not a member of the OECD.

15. With respect to whether the OECD member states are bound by the interpretations in the OECD Commentary unless they have registered an observation or reservation, see F. Engelen, *How ‘Acquiescence’ and ‘Estoppel’ Can Operate to the Effect That the States Parties to a Tax Treaty are Legally Bound to Interpret the Treaty in Accordance with the Commentaries on the OECD Model Tax Convention*, in *The Legal Status of the OECD Commentaries* pp. 51-72 (S. Douma & F. Engelen eds., IBFD 2008), Books IBFD; and D.A. Ward, *Is There an Obligation in International Law of OECD Member Countries to Follow the Commentaries on the Model?*, in *The Legal Status of the OECD Commentaries* pp. 73-93 (S. Douma & F. Engelen eds., IBFD 2008), Books IBFD.

16. See, for example, the sources listed in footnote 9 of Ward et al., *supra* n. 10.

17. See Ward et al., *supra* n. 10, at pp. 15-27.

18. This is not surprising given that the Commentaries are the product of the diverse views of tax officials from over 30 OECD member countries, in the case of the *OECD Commentary*, and of 25 members of the UN Committee of Experts, in the case of the *UN Commentary*.

19. The same 2014 *OECD Commentary* is repeated for all of the articles that refer to beneficial owner. See paras. 12-12.7 *OECD Commentary on Article 10*, paras. 10.1-11 *OECD Commentary on Article 11*, and paras. 4-4.6 *OECD Commentary on Article 12*. In contrast, the *UN Commentary* adopts the wording of the 2010 *OECD Commentary* rather than the 2014 *OECD Commentary* except with respect to article 12A, which appears to be a mistake. See para. 13 *UN Commentary on Article 10*, para. 18 *UN Commentary on Article 11*, para. 5 *UN Commentary on Article 12* and paras. 52-58 *UN Commentary on Article 12A*. See A. Martín Jiménez, *Beneficial Ownership*, Global Topics IBFD (accessed 13 Aug. 2021) for a detailed discussion of the changes in the OECD Commentary with respect to the meaning of “beneficial owner.” Another

20. These commentators and courts emphasize the parts of the Commentary that refer to a recipient of an item of income having the right to use or enjoy that income “unconstrained by a contractual or legal obligation to pass on the payment received to another person.” See the articles in M. Lang et al., eds., *Beneficial Ownership: Recent Trends* (IBFD 2013), Books IBFD.

21. These commentators and courts emphasize the parts of the Commentary that refer to “substance” and to beneficial owner as a means of dealing with tax avoidance.

22. See, for example, AU: Acts Interpretation Act, 1901, secs. 15AA and 15AB; CA: Income Tax Conventions Interpretation Act, RSC 1985, c. I-4; UK: Taxes Act, s. 788; UK: ICTA, Schedule 30; and UK: Finance Act 2000, s. 793A(3).

23. See, for example, *United States Model Income Tax Convention* (17 Feb. 2016), Treaties & Models IBFD.

24. Foreign cases are not treated as binding precedents but as extrinsic aids to the interpretation of a treaty. Cases decided by the courts of a country’s treaty partners are especially relevant because of the desirability for a treaty to be interpreted in the same manner in both contracting states (common interpretation).

cles) in tax treaty cases is quite common in some countries. *Klaus Vogel on Double Taxation Conventions*<sup>24</sup> appears to be the source most referred to, although other treatises and articles on tax treaties are also noted on occasion. Although a vast body of literature on the interpretation and application of tax treaties is available to national courts, it appears that the courts in most countries rarely, if ever, refer to such material, either because it is unavailable or because the judicial culture does not encourage such reference. Another possible reason may be the lack of authoritative official material with respect to the interpretation of tax treaties in most countries. Many national courts may be understandably reluctant to consider the unofficial opinions of scholars or the one-sided administrative positions of one country in interpreting tax treaties, despite the fact that such material is not intended to be binding on national courts.

### 3. An Assessment of the Quality of National Courts' Decisions on Tax Treaties

To say that a comprehensive assessment of the performance of national courts in deciding tax treaty cases is beyond the scope of this brief article would be a gross understatement. My impression is that national courts have made serious mistakes in deciding tax treaty cases. This impression is not based on a comprehensive analysis of tax treaty cases around the world, but rather on a selective examination of tax treaty cases from several countries over many years, including a survey of Klaus Vogel's reviews of tax treaty cases in the *Bulletin for International Taxation* from 2000 to January 2008,<sup>25</sup> and the similar impressions of colleagues who are tax treaty experts. To bolster these impressions, a small selection of tax treaty cases from several countries in which the courts have made fundamental errors – not just made controversial decisions about which people can reasonably differ – is provided in the annex to this article.

### 4. Why Do National Courts Make Fundamental Errors in Interpreting Tax Treaties?

There is no simple answer to this question, and some may even reject the implicit assumption that national courts have difficulty dealing with tax treaty cases (or at least have more difficulty than they do dealing with domestic tax issues). However, some factors that likely contribute to the failure of national courts to deal appropriately with tax treaty cases are:

- Tax is a specialized subject for most judges, and tax treaties are even more specialized. Many national courts that deal with tax and tax treaty issues are generalist courts that do not have or develop special expertise with respect to tax treaties. For countries

that have specialist tax courts, such courts are usually lower-level courts.

- In countries with adversarial judicial proceedings, courts may be limited by the quality and knowledge of counsel appearing on behalf of the parties. If counsel are not knowledgeable about tax treaties, they may inadvertently mislead the court.
- Many basic aspects of the operation of tax treaties are not obvious from a close reading of the provisions of the treaty itself or a review of the relevant portions of the Commentary on the comparable provisions of the OECD or UN Models. A few examples will serve to illustrate the difficulty faced by national courts in understanding the underlying principles of tax treaties:
  - first, tax treaties limit the imposition of domestic tax by the contracting states; they do not generally impose tax and they do not allocate taxing rights between the contracting states, although they are often portrayed as doing so; instead, they limit the application of domestic tax. The mistaken view that tax treaties allocate taxing rights between the treaty partners can lead to incorrect decisions because it may induce courts to search for a country's right to tax in the provisions of the treaty rather than for a limitation in those provisions on a country's taxing rights under its domestic law. The absence of any provision in the treaty preventing or limiting a country's right to tax an item of income means that the item is taxable as long as it is taxable under the country's domestic law; the treaty is irrelevant;
  - second, the relationship between tax treaties and domestic law often generates issues that require a sophisticated understanding of that relationship. For example, although, in general, tax treaties prevail over domestic law in the event of a conflict, tax treaties do not displace domestic law entirely. Thus, where the tie-breaker rule in a treaty applies to make a taxpayer a resident of one of the countries (and not a resident of the other country), it does so only for the purposes of the treaty and not for the purposes of either country's domestic law;<sup>26</sup> and
  - a third example is the relationship between the provisions of a tax treaty. Although there are some specific priority rules in tax treaties based on the OECD and UN Model Conventions to resolve conflicts where two provisions of the treaty apply to the same item of income,<sup>27</sup> such

24. E. Reimer & A. Rust, eds., *Klaus Vogel on Double Taxation Conventions* (4th ed., Kluwer 2015).  
 25. K. Vogel, Tax Treaty Monitor, Tax Treaty News was a regular feature of the *Bulletin for International Taxation* for many years. Professor Vogel's last column was published posthumously in January 2008.

26. Unless there is a special provision in a country's domestic law providing that, where a person who would otherwise be a resident of that country under its domestic law is deemed to be a resident of the other country under the tie-breaker rule in the treaty, the person is also deemed not to be a resident of the first country for purposes of its domestic law.  
 27. See, for example, arts. 10(4) and 11(4) of the *OECD Model* and the *UN Model*.

explicit rules are often lacking.<sup>28</sup> Article 7 of the OECD Model allows a contracting state to tax a resident of the other state on business profits attributable to a permanent establishment (PE) in the first state where the resident carries on business through a PE in the first state. Although it is widely thought that article 7 requires the PE state to tax the profits attributable to a PE on a net basis, in fact, article 7 does not *prescribe any particular method* of taxing the profits attributable to a PE. However, article 24(3) dealing with non-discrimination prevents a country from taxing a PE of a resident of the other country less favourably than it taxes its own residents carrying on the same activities. Thus, where a country taxes its own residents carrying on business on a net basis, article 24(3) requires that country to tax residents of the other country carrying on business through a PE in the first country no less favourably. This means that the country cannot impose more tax on the non-resident's profits attributable to the PE than it would impose on its own residents, determined on a net basis. In other words, article 24(3) establishes a limit on the amount taxable by the PE country, not on the method of taxation (net or gross) used by that country. Moreover, where the PE country taxes the business profits of its own residents on a gross basis, neither article 7 nor article 24(3) requires the PE country to tax the profits attributable to the non-resident's PE on a net basis.

## 5. Possible Remedies

### 5.1. Introductory remarks

Having attempted to establish that there is a serious problem with the interpretation and application of tax treaties by national courts, the rest of the article briefly examines two solutions to remedy the problem.

### 5.2. The use of the mutual agreement procedure under article 25(3)

In a recent article in the *Bulletin for International Taxation*, Jacques Sasseville suggests the use of the authority conferred on the competent authorities of the contracting states to resolve “difficulties or doubts as to the interpretation or application of the Convention” under the first sentence of article 25(3) of the OECD and United Nations models.<sup>29</sup> Sasseville points out that a mutual agreement between the competent authorities as to the interpretation of a treaty is preferable to a decision by the national courts of one state because the mutual agreement would be binding on both states. Sasseville goes even further to suggest that all interpretive disputes should be resolved exclusively through the mutual agreement procedure,

28. For example, there is no explicit rule to deal with conflicts between arts. 6 and 7.

29. J. Sasseville, *The 2017 Changes to Article 3(2) of the OECD Model: Comments on Professor Alexander Rust's Presentation*, 74 Bull. Intl. Taxn. 4/5 (2020), Journal Articles & Opinion Pieces IBFD.

with recourse to national courts precluded.<sup>30</sup> He recognizes that such a drastic change would be unacceptable to most countries and to taxpayers, especially where a country's treaties do not provide for mandatory arbitration of interpretive disputes and do not allow taxpayers to participate in the process. Therefore, as a more modest approach, he suggests that countries should require taxpayers to use the mutual agreement procedure to resolve interpretive issues as a precondition for an appeal to the courts. Such a requirement “would clarify the interaction between MAP and domestic litigation and would ensure that both competent authorities are aware of any dispute related to the application of the tax treaty concluded between their States.” An additional benefit is that, if a taxpayer appealed to the national courts despite a mutual agreement under article 25(3), the courts would be unlikely to render a decision contrary to the interpretation agreed to by both parties to the treaty as the proper interpretation of the terms of their agreement.

I endorse Jacques Sasseville's suggestions to authorize the competent authorities to resolve interpretive issues through the use of the mutual agreement procedure. However, I am sceptical that governments, international organizations, national courts and taxpayers would be prepared to give exclusive jurisdiction over interpretive issues to the competent authorities or even to make a competent authority agreement a condition for access to national courts. I am also concerned that the competent authorities might be tempted to resolve interpretive issues on a basis inconsistent with the terms of the treaty<sup>31</sup> and different from the way in which the treaty should be properly interpreted by the courts. There is also the real possibility that the competent authorities might not be able to reach an agreement.<sup>32</sup>

### 5.3. Expert advisory opinions on the interpretation of a tax treaty

As an alternative to the use of the mutual agreement procedure, I propose a mechanism to enable national courts to obtain access to non-binding advice from independent tax treaty experts on the proper interpretation of a treaty in particular cases. The advantages of the system of advisory opinions that I propose over the use of the mutual agreement procedure are: first, a system of advisory opinions can be implemented unilaterally by each country without the need for an agreement of the competent authorities; and second, such a system eliminates any concerns about giving up national sovereignty or restricting access to, or the authority of, national courts. However, unlike the use of the mutual agreement procedure, a unilateral system of

30. Under the OECD Model, mandatory arbitration is not available for mutual agreements under art. 25(3), although the contracting states are free to extend arbitration to such disputes, see *OECD Model Tax Convention on Income and on Capital: Commentary on Article 25* para. 73 (21 Nov. 2017), Treaties & Models IBFD.

31. Perhaps in an attempt to fix errors in the language of the treaty and avoid the need to amend to treaty.

32. Interpretive agreements under art. 25(3) are not used frequently, and mandatory arbitration is not usually applicable to mutual agreements under art. 25(3).

advisory opinions will not necessarily ensure that a treaty is interpreted in the same way in both states.<sup>33</sup>

Although space does not allow for a detailed discussion of the design of a system of expert advisory opinions, the broad outline of such a system is set out below with the intention of providing some ideas to generate discussion.<sup>34</sup> The legal process for the adoption or implementation of a system of expert advisory opinions to assist national courts in tax treaty cases will inevitably differ depending on the structure of the judicial system in each country. Some countries may require domestic legislation to authorize the use of expert advisory opinions; the courts of other countries may have the authority under their existing rules to implement such a system without the need for legislation. In any event, the necessary action to adopt a system of expert advisory opinions would not appear to be onerous.

### 5.3.1. *Initiation of the process*

The process would be initiated by either the taxpayer or the tax authorities involved in a judicial dispute making an application to the court at the first level. This would take place within a reasonable amount of time after the litigation commences so that the court could order the appointment of a qualified independent expert to render a written opinion on the interpretation of the relevant provisions of the treaty in a timely manner (say, 60 days). The consent or agreement of the other party for the court order would not be required. The court's decision on whether to order the appointment of an expert or not would be subject to appeal like any similar decision of the court.

### 5.3.2. *Qualified treaty experts*

The OECD Committee on Fiscal Affairs and the United Nations Committee of Experts could be given responsibility for creating and maintaining a list of qualified tax treaty experts.<sup>35</sup> To protect the integrity of this process, robust criteria should be established for listing experts, including their experience negotiating or administering tax treaties, providing professional advice about tax treaties and writing about tax treaties. Obviously, the list should include experts from several countries, including developing countries.

### 5.3.3. *Appointment of an expert*

It is crucial for any expert appointed by a court to be knowledgeable and independent, without any actual or potential conflicts of interest. The expert's role would be to assist the court in dealing with the issues in the case that involve the interpretation of a tax treaty. The expert would be responsible to the court, not to either of the

33. However, as Sasseville concedes, the courts of some countries (for example, Germany and the Netherlands) have taken the position that they are not bound to follow a mutual agreement concluded under the first sentence of article 25(3). Sasseville, *supra* n. 29, at p. 2.  
 34. The idea might be a suitable topic for discussion by the International Association of Tax Judges (see www.iatj.net).  
 35. See, for comparison, the list of tax treaty arbitrators at www.tribute-arbitrators.org.

parties to the litigation. Ideally, the expert appointed in any particular case would not be a resident or citizen of either contracting state, although it might be appropriate in some circumstances (for example, where the issue in the case involves the interaction of domestic law and the provisions of the tax treaty) for the court to appoint an expert with expert knowledge of both domestic law and tax treaties. The appointment of the expert would specify the terms of reference for the expert's opinion; however, it is important for an opinion to go beyond the terms of reference, if necessary, to ensure that the provisions of the treaty are properly interpreted and applied in the case. An expert would be provided with the necessary information with respect to the facts of the case, the tax treaty and the relevant domestic law and would be subject to appropriate confidentiality requirements.

### 5.3.4. *Nature of an expert's opinion*

An expert would be required to prepare a written opinion with respect to the proper interpretation of the tax treaty, with detailed reasons explaining and supporting the conclusions reached in the opinion. The written opinion would be provided to the court and to both parties. Both parties should have the opportunity to comment on the expert's opinion at the appropriate time during the litigation. To reduce the cost of obtaining an expert opinion, the expert would not be required to give oral testimony. In extraordinary circumstances, the court should be entitled to request clarification from an expert of aspects of the expert's opinion. In the interest of transparency, any such follow-up clarifications should be made available to the parties.

Although the court would be expected to consider an expert opinion, such an opinion would not be binding on the court. Ordinarily, it would be expected that any court that requests an advisory opinion would consider that opinion in its decision.

### 5.3.5. *Publication*

Any expert opinion should be made available to the public as part of the documentary record of the case.

### 5.3.6. *Cost*

It is important to minimize the cost of obtaining advisory opinions from tax treaty experts, as is also the case with the compensation of arbitrators under the mandatory arbitration procedure.<sup>36</sup> Although treaty experts should be reasonably compensated for their work, for most treaty experts, the prestige associated with an appointment as an expert with respect to tax treaties is likely to be more significant than the amount of remuneration. The cost could be borne entirely by the party applying for the appointment of an expert, shared equally by both parties or borne by the public as part of the judicial process.

36. For example, the remuneration of arbitrators under the rules of the International Centre for Settlement of Investment Disputes is USD 3,000 per day. Limiting the cost is especially important for developing countries if the government is required to bear the cost.

## 6. Conclusions

This article has suggested (albeit on the basis of largely anecdotal evidence) that national courts make frequent and serious mistakes in deciding cases involving the interpretation and application of tax treaties. The article argues that this problem is sufficiently serious and widespread that measures should be considered to deal with the problem. It suggests two possible solutions: the use of the mutual agreement procedure either to resolve interpretive disputes to the exclusion of national courts or as a condition for taxpayers to access national courts, and the adoption of a system to allow non-binding advisory opinions prepared by tax treaty experts to be made available to national courts to assist them in reaching their decisions in particular cases.

### Annex: Selective List of Tax Treaty Cases with Fundamental Mistakes

The following cases are organized by country. They are not discussed in detail, but only sufficiently to identify the errors made by the courts with respect to tax treaties. Additional cases with serious mistakes are noted in the footnotes to supplement the illustrative use of the cases discussed in the text.

#### Australia

*Resource Capital Fund III LLP v. Commissioner of Taxation* (2013) FCA 363. The Court held that although a hybrid entity was not a resident of the United States for purposes of the Australia-United States treaty, the treaty prevented Australia from taxing the entity on a capital gain from the disposition of immovable property situated in Australia. The Court made the fundamental mistake of searching the provisions of article 13 (Capital Gains) for a provision giving Australia the right to tax the gain, instead of recognizing that Australia had the right to tax the gain under its domestic law and nothing in article 13 or in the rest of the treaty limited that right. In fact, article 13(7) provided explicitly that each contracting state had the right to tax any gains not covered by the other provisions of article 13.

*Commissioner of Taxation v. SNF Australia* (2011) FCAFC 75. The court concluded that the OECD Transfer Pricing Guidelines “are not a legitimate aid to the construction of double taxation conventions,” despite the fact that they have been incorporated into article 9 of the OECD Model.

#### Austria

In an unnamed 2006 Austrian case reviewed by Klaus Vogel,<sup>37</sup> the Austrian court denied the treaty exemption for dividends paid by a Maltese offshore company to an Austrian-resident shareholder on the basis that the dividends were not taxable by Malta. However, the treaty

37. See K. Vogel, *Tax Treaty News*, 60 Bull. Intl. Taxn. 12, p. 474 (2006), Journal Articles & Opinion Pieces IBFD. For a German case making the same error with respect to Austrian athletes (asserting that it could not have been the intention of the contracting states that Austrian athletes performing in Germany would be exempt from tax in Germany, where they were not taxable in Austria on their income) see K. Vogel, *Tax Treaty News*, 57 Bull. Intl. Taxn. 1, pp. 2-3 (2003), Journal Articles & Opinion Pieces IBFD.

exemption for dividends was not conditional on the taxation of the dividends by the other state. In general, where the provisions of the OECD and UN Models restrict the right of the source country to tax items of income such as dividends, interest, royalties and capital gains, they do not make the restriction conditional on taxation of the income by the residence country; as a result, it is up to the residence country to decide whether it wants to tax the income under its domestic law.

#### Canada

*The Queen v. Crown Forest Industries Ltd.* (1995) SCJ 56. Both the Tax Court and the Federal Court of Appeal mistakenly held that a Bahamian-incorporated company was a resident of the United States and entitled to the benefits of the Canada-United States treaty on the basis that it was carrying on business through an office in the United States; the Supreme Court correctly rejected the lower courts' decisions.

*Specialty Manufacturing Ltd. v. The Queen*, A-659-18 FCA (1999). In considering whether the provisions of the Canada-United States treaty prevented Canada from disallowing the deduction of interest under the thin capitalization rules, neither the Federal Court of Appeal nor the Tax Court realized that the treaty included a saving clause that explicitly allowed each state to tax its residents without regard to the treaty.

#### India

*Union of India v. Azadi Bachao Andolan* (2003) 263 ITR 706/132 (SC). The Supreme Court upheld an administrative circular indicating that a certificate of residence from Mauritius was sufficient to establish residence and beneficial ownership of a corporate shell in Mauritius under the India-Mauritius tax treaty, on the basis that treaty shopping was desirable for developing countries. The Court stated that “many principles in fiscal economy which, though at first blush might appear to be evil, are tolerated in a developing economy in the interest of long-term development. Deficit financing, for example, is one; treaty shopping is another.”

*Commissioner of Income Tax v. P.V.A.L. Kulandagan Chettiar* (2004) 267 ITR 654/137 (SC). The Supreme Court held that a firm resident in India that derived income from Malaysia was not subject to Indian tax on the income despite the fact that article 7(2) of the treaty with Malaysia provided only that the income “may be taxed” in Malaysia. In effect, the court incorrectly interpreted the phrase “may be taxed” in Malaysia as meaning “shall only be taxed” in Malaysia.

#### Italy

*NatWest as Trustee v. Italian Revenue Agency*, Cass. 2618-2020. A trust resident in the United Kingdom acting as a collective investment vehicle (CIV) was denied treaty benefits with respect to dividends received from Italian companies even though the trust was a resident of the United Kingdom and subject to UK corporation tax on the relevant income. Among other mistakes, the Italian Supreme Court indicated incorrectly that the UK trust had to be a

person under the law of both contracting states in order to qualify for treaty benefits and failed to refer to the clear statements in the OECD Commentary on the appropriate treatment of CIVs.

#### *New Zealand*

*FFF v. Commissioner of Inland Revenue* (2011) NZTRA 8. The Court made several mistakes in applying the residence tie-breaker rules for individuals in the Fiji-New Zealand treaty, finding that rented accommodation does not constitute a permanent establishment and that a habitual abode should be determined on the basis of the taxpayer's entire working career.

*Commissioner of Inland Revenue v. Patty Tzu Chou Lin* (2018) NZCA 38. The provisions of the China-New Zealand treaty should have prevented New Zealand from applying its controlled foreign corporation (CFC) rules to tax the income of CFCs in China; however, the Court of Appeal applied the literal meaning of the treaty, ignoring the OECD Commentary.

#### *South Africa*

*Commissioner for the South African Revenue Service v. Tradehold Limited*, Case No. 132/11 (2012) ZASCA 61. The South African Supreme Court held that article 13 (Capital Gains) gave Luxembourg the exclusive right to tax gains on shares (other than shares in land-rich companies); therefore, the Court incorrectly concluded that South Africa was precluded from imposing tax on the gain under its domestic exit tax, even though that tax was imposed on the gain from the deemed disposition of the shares before the taxpayer ceased to be resident in South Africa.

#### *Spain*

In three cases<sup>38</sup> the Spanish Supreme Court held, contrary to the courts of other European countries, that certain

contract manufacturing and commissionaire arrangements gave rise to PEs in Spain.

Although the Supreme Court has generally interpreted the beneficial owner requirement as a broad anti-avoidance measure, in Rec. No. 1196/2020 (*Colgate*), 23 September 2020, it refused to read such a requirement into article 12(2) (Royalties) of the Spain-Switzerland tax treaty, despite the fact that the term "beneficiary" is used twice in other paragraphs of the article and Switzerland considers the beneficial owner requirement to be implicit in article 12.

#### *United Kingdom*

*Padmore v. IRC* (1989) STC 493 May 19, 1989. The Court held, incorrectly, that the provisions of the Jersey-United Kingdom treaty prevented the United Kingdom from imposing tax on a UK resident's share of the profits of a Jersey partnership earned in the United Kingdom. Tax treaties do not generally prohibit a country from taxing its own residents, especially on domestic source income.

*Boake Allen Limited et al. v. HMRC* (2007) UKHL 25. The House of Lords incorrectly limited article 24(5) to discrimination based on nationality by reading into article 24(5) the nationality requirement in article 24(1).

*Smallwood Estate v. HMRC* (2009) EWHC 777 (Ch), reversed (2010) EWCA Civ 778 (UK Court of Appeal). Three levels of UK courts differed as to whether article 13(4) required the alienator to be a resident of the United Kingdom at the time of the disposal of the property or whether residence in the United Kingdom for the entire year was sufficient.

#### *United States*

*Savary v. Commissioner of Internal Revenue*, T.C. Summ. Op. 2010-150, No. 6839-09S (US Tax Court). A US citizen resident in France was subject to tax in both countries on her worldwide income; the US Tax Court held incorrectly that the elimination of double taxation article in the France-United States tax treaty required France, not the United States, to provide relief from the double taxation.

38. ES: TS [Supreme Court], 18 June 2012, Rec. No. 1933/2011 (*Borax*), Case Law IBFD; ES: TS [Supreme Court], 12 Jan. 2012, Rec. No. 1626/2008 (*Roche*), Case Law IBFD; and ES: TS [Supreme Court], 20 June 2016, Rec. No. 2555/2015 (*Dell Spain*), Case Law IBFD. See A. Martín Jiménez, *The Spanish Position on the Concept of a Permanent Establishment: Anticipating BEPS, Beyond BEPS or Simply a Wrong Interpretation of Article 5 of the OECD Model?*, 70 Bull. Intl. Taxn. 8, pp. 458-473 (2016), Journal Articles & Opinion Pieces IBFD.