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Tax Treaty Override and the Need for Coordination between Legal Systems: Safeguarding the Effectiveness of International Law[1]

Treaty override, which generally concerns international law, has a specific connotation with regard to international tax law. The specific connotation of tax treaty override essentially depends on the structure and functioning of the OECD Model on which tax treaties are commonly based. Thus, a study of tax treaty override, regardless of the classification as a monist or dualist system, necessarily involves, on the one hand, an analysis of the relationship between general international law and international tax law and, on the other hand, an analysis of the relationship between international and national law. The first analysis is directed at understanding the structure of tax treaty override and, therefore, at determining the core of the interpretative process which underlies its detection. The examination of the relationship between international and national law is, instead, functional at evaluating the legitimacy (or illegitimacy) of tax treaty override.

It is also important to emphasise that nowadays, very often, the relevant relationship is not only between sources of national and international law, but it necessarily involves – as an additional parameter – EU law. This is true not only for the EU Member States, but also for third countries that conclude international treaties with them, and whose rights could easily be affected by a subsequent change to EU law. In this context, treaty override is the most damaging manifestation of lack of effectiveness of international law, which means lack of legal protection for economic operators – and therefore taxpayers – acting globally. For this reason, the resolution of the issues concerning tax treaty override represents an important step towards a necessary consolidation of the relationship between national, international and EU law. This consolidation will guarantee more certainty of law.

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1. This article discusses some of the issues dealt with in the PhD thesis of the author. This thesis has been written on the basis of a joint PhD programme between the University of Bologna and Tilburg University. *See* C. De Pietro, *Tax Treaty Override* EUCOTAX Series on European Taxation, n. 40, Wolters Kluwer, 2014.

1. Introduction: Coordination between Legal Sources as the Essence of Tax Treaty Override

Treaty override has remained an unresolved issue and for this reason, as evidenced by the pending decisions of the German Constitutional Court,[2] still open and debated. After the episodic strong stance of the OECD with the 1989 Report,[3] the matter has been left to the states without actually arriving at a unique and shared solution. Thus, in those states (monist) in which international law has direct effect, treaty override is considered illegitimate because international law prevails over national law. In contrast, in those states (dualist) in which international law has no direct effect, it must be incorporated and transformed into national law. As a consequence, treaty override is considered legitimate because a domestic law of equal rank in the hierarchy of national sources may override the previous domestic law incorporating the international treaty (*lex posterior abrogat priori*).

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A conception of the relationship between national and international law in terms of monism or dualism is no longer considered appropriate by some authors given the fact that each state has the concrete power to establish what effects international law has within its own legal system.

Thus, Vereshchetin stated: "The fact that monist and dualist concepts were advanced and elaborated mainly on a speculative basis, in the absence of any solid constitutional practice, which could prove or disprove them, and in an absolutely different international setting, deprives these concepts of a guiding role in modern constitution-making. The legislator, instead of taking sides in the endless and sterile doctrinal debate, should rely and is, in fact,

2. The German Federal Tax Court (*Bundesfinanzhof*, BFH) has requested the German Federal Constitutional Court to decide about the constitutionality of tax treaty override (*see Bundesfinanzhof* (BFH), 10.01.2012, I R 66/09, BFHE 236, 304, *Bundesfinanzhof* (BFH) 11.12.2013, I R 4/13, BFHE 244, 1 and *Bundesfinanzhof* (BFH) 20.08.2014, I R 86/13, BFH/NV-2014-1985). The decisions of the Constitutional Court are still pending. For comments on these cases, *see* A. Perdelwitz, *Treaty Override – Revival of the Debate over the Constitutionality of Domestic Treaty Override Provisions in Germany*, 53 Eur. Taxn. 9 (2013), pp. 445-450, Journals IBFD; A. Cloer & T. Hagemann, *Federal Tax Court Holds Treaty Override Unconstitutional*, 54 Eur. Taxn. 11 (2014), Journals IBFD, pp. 510-516. *See also* C. Kahlenberg, *German Treaty Override Violates Constitutional Law*, 68 Bull. Intl. Taxn. 9 (1986), pp. 480-487, Journals IBFD.

3. OECD Ctr. for Tax Policy and Admin., *Tax Treaty Override* (OECD 1989), International Organizations' Documentation IBFD.

increasingly relying, on a proper understanding of the national interests in conformity with the exigencies of contemporary international life".[4]

In the same line of reasoning, Fitzmaurice emphasized: "The entire monist-dualist controversy is unreal, artificial and strictly beside the point …".[5]

Regardless of the strict characterization as a monist or dualist system, in the opinion of the author of this article, a conception of the relationship between international and national law in terms of prevalence of one over the other does not correspond to the actual relationship between international tax law and domestic tax law, as defined by the relationship between general international law and international tax law (specfically, the OECD Model).

The analysis below will show that the relationship between general international law and international tax law results in a very particular connotation conferred to tax treaty override. The OECD Model, on which tax treaties are commonly based, reverses the relationship between international law and domestic law as traditionally established by international treaties. With a few exceptions, there are no substantive international provisions substituting domestic provisions. On the contrary, it is domestic law that applies, although to the extent established by the international agreement. The structure and functioning of the OECD Model requires coordination between international tax law and national tax law. The identification of a case of tax treaty override is, therefore, based on an interpretative process aimed at verifying whether this coordination has been disrupted.

Clearly, the international agreement is central in a conception of tax treaty override which takes into consideration the relationship between international tax law and domestic tax law as established by the OECD Model.

The contracting states – on the basis of each individual international agreement – establish a certain balance between international tax law and domestic tax law. This means that it is in the power of the contracting states to establish to what extent national law can be amended without effecting a case of tax treaty override.

This central position of the international agreement can (and should) be guaranteed in dualist systems as well. In Italy, which is a country with a long dualist tradition, a constitutional reform implemented in 2001 has reached this result. As it will be explained below, regardless of the incorporation and transformation of international law into national law, an international obligation as such limits national sovereignty and is, therefore, binding upon the contracting states.

Finally, it will be argued that in a globalized economy also the problem of the relationship between national, international and EU law necessarily stands in terms of coordination. Nowadays, very often the relevant relationship is not only between sources of national and international law, but it necessarily involves – as an additional parameter – EU law. This is true not only for the EU Member States, but also for third countries that conclude

4. H.E.V.S. Vereshchetin, *Some Reflections on the Relationship between International Law and National Law in the Light of New Constitutions*, in R. Müllerson, M. Fitzmaurice & M. Andrenas (eds.), *Constitutional Reform and International Law in Central and Eastern Europe* (Kluwer Law International, 1998), pp. 6-7.
5. G. Fitzmaurice, *The General Principles of International Law Considered from the Standpoint of the Rule of Law*, 92 Recueil des Cours (1957-II), p. 71.

international treaties with them, and whose rights could easily be affected by a subsequent change to EU law.

In this context, treaty override is the most damaging manifestation of lack of effectiveness of international law, which means lack of legal protection for economic operators – and therefore taxpayers – acting globally. For this reason, the resolution of the issues concerning tax treaty override represents an important step towards a necessary consolidation of the relationship between national, international and EU law. This consolidation will guarantee more certainty of law.

2. General International Law and International Tax Law: Structure of Tax Treaty Override

Treaty override generally concerns international law. Under general international law treaty override has a broad connotation as it indicates any breach of an international treaty. However, treaty override assumes unique characteristics in regard to international tax law, where it is at its most complex.

The specific nature of tax treaty override is related to the structure and functioning of the OECD Model on which tax treaties are commonly based. Therefore, the application of general international law needs to be coordinated with international tax law by taking into consideration the particular structure and functioning of the OECD Model.

Generally speaking, an international treaty introduces international provisions which substantially govern a certain matter. Very different is the case of tax treaties based on the OECD Model. In order to avoid double taxation, the OECD Model uses formal criteria, the so-called distributive rules, that establish which contracting state has the right to tax (or to what extent each contracting state may tax).

Vogel stated: "DTCs establish an independent mechanism to avoid double taxation through restriction of tax claims in areas where overlapping tax claims are expected, or at least theoretically possible. In other words, the contracting States mutually bind themselves not to levy taxes, or to tax only to a limited extent, in cases when the treaty reserves taxation for the other contracting State either entirely or in part. Contracting States are said to 'waive' tax claims … or more illustratively to divide 'tax sources', 'the taxable objects' (Steuergut) among themselves".[6]

The characteristic that marks tax treaties based on the OECD Model is that these treaties do not establish (with a very few exceptions) substantive rules which govern taxation in each contracting state. On the contrary, the functioning of tax treaties based on the OECD Model is guaranteed through the application of domestic law, which is, however, restricted by international formal distributive rules.

Each distributive rule does not establish how a certain item of income or capital should be taxed in each contracting state. It establishes to what extent domestic law, which governs taxation of a certain item of income or capital, may apply.

6. *See* K. Vogel et al., *Klaus Vogel on Double Taxation Conventions*, 3rd ed. (Kluwer Law International, 1997), pp. 26-27.

In addition, as highlighted by Vogel, the distributive rules of the OECD Model are not conflicts of law rules like those applicable in private international law. The functioning of the OECD Model is not based on the prevalence of one contracting state national law on the national law of the other. National law of both contracting states applies to the extent admissible under each distributive rule. Therefore, Vogel defines the OECD Model's distributive rules as "rules of limitation of law".[7]

Each distributive rule gives rise to a delicate and often complex relationship between treaty provisions and domestic law. Sinclair stated: "the object and purpose of a bilateral tax treaty is not to unify or harmonise the laws of the two States concerned; it is rather to provide relief from tax in that State which would or might otherwise charge it. *There is, therefore, an intimate connection between the relieving provisions and the charging provisions of internal law …*".[8]

It is exactly this "intimate" relationship, which Jeffery has defined as symbiotic,[9] that is at the basis of an analysis aimed at individuating cases of tax treaty override.

As a consequence, when establishing whether a case of tax treaty override has occurred the relationship between international and national law must not be taken into consideration merely in terms of prevalence of one over the other but rather in terms of coordination. This is required by the tax treaties based on the OECD Model precisely because their functioning is guaranteed by the combined application of international and national law and not on the substitution of a domestic substantive provision with an international substantive provision.

Accordingly, Garbarino explains: "an interpretation of tax treaties that leaves completely aside domestic law is not actually possible. Tax treaties complete and presuppose domestic law …".[10]

Exactly because tax treaties limit the application of substantive domestic law through the application of formal criteria, i.e. distributive rules, the determination whether a case of tax treaty override has occurred firstly requires to distinguish between those tax rights which are still within national sovereignty and those rights which, instead, have been restricted and, therefore, can no longer be exercised by the contracting states.

Accordingly, Vogel states: "Within the scope of a treaty … a tax obligation exists only if and to the extent that, in addition to the requirements of domestic law, the treaty requirements also are satisfied".[11]

Arguing *a contrario*, it is possible to say that the establishment of the delicate relationship between substantive domestic law and formal treaty provisions requires the exact establish-

7. Id., p. 20.
8. J.F. Avery Jones, *Interpretation of Tax Treaties*, 40 Bull. Intl. Fiscal Docn. 1 (1986), p. 77, Journals IBFD (emphasis added). This article is a transcription by Avery Jones of seminar B at the IFA Congress held in London in 1985.
9. R.J. Jeffery, *The Impact of State Sovereignty on Global Trade and International Taxation*, Series on International Taxation, no. 23 (Kluwer Law International, 1999), p. 104.
10. C. Garbarino, *Manuale di tassazione internazionale*, 2nd ed. (IPSOA Wolters Kluwer Italia, 2008), 194 (author's translation: "*… un'interpretazione delle Convenzioni contro le doppie imposizioni che prescinda totalmente dalla legislazione interna non é attuabile in concreto. Le Convenzioni fiscali completano e presuppongono le legislazioni nazionali …*").
11. *See* Vogel et al., *supra* n. 6, p. 20.

ment of all the elements characterizing a distributive rule and to what extent they have incidence on the exercise of national tax jurisdiction.[12]

It is clear that determining whether a case of tax treaty override has occurred is essentially a matter of interpretation. In this respect, article 3(2) of the OECD Model plays a central role. This interpretative clause determines a connection, on the one hand, between general international law and international tax law and, on the other hand, between domestic tax law and international tax law. In fact, article 3(2), exactly reflects the structure of the OECD Model.

Article 3(2) establishes: "As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies…". This provision concerns the interpretation of terms which are used by a tax treaty but not defined therein and establishes that these terms shall have the meaning that – at the moment of the application of the tax treaty – they have under the domestic law of the contracting state which is applying the treaty.

According to Vogel, the provision at issue is a general interpretative clause in respect to other more specific interpretative rules contained within the OECD Model. However, it is *lex specialis* in respect to the interpretative provisions of the Vienna Convention on the Law of Treaties.[13] Under these provisions, the interpretation of international treaties is generally based on the use of common international definitions which prevail on the domestic ones. According to article 31(1), "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". Thus, the definition of treaty terms is based on their international ordinary meaning which substitutes the national definition.

Article 3(2) of the OECD Model also recognizes the applicability of the international meaning of tax treaty terms, nevertheless only subordinately to domestic law. Domestic definitions, even when they have been modified after the conclusion of the treaty (so-called ambulatory interpretation), are applicable. Only when the context otherwise requires and, therefore, a treaty uses a term which is not defined therein but this term has an ordinary international meaning, this international meaning applies. This is because the international meaning expresses the common will of the contracting parties.

12. *See* De Pietro, *supra* n. 1, p. 163 et seq., where an interpretative model is developed and applied.
13. *See* Vogel et al., *supra* n. 6, pp. 209, 211. On the nature of article 3(2) of the OECD Model as *lex specialis*, *see also* F.A. Engelen, *Interpretation of Tax Treaties under International Law: A Study of Articles 31, 32 and 33 of the Vienna Convention on the Law of Treaties and Their Application to Tax Treaties*, IBFD Doctoral Series, vol. 7 (IBFD 2004), p. 478 et seq., Online Books IBFD; P.J. Wattel & O. Marres, *Characterization of Fictitious Income under OECD-Patterned Tax Treaties*, 43 Eur. Taxn. 3 (2003), p. 66, Journals IBFD; H.A. Shannon, *United States Income Tax Treaties: Reference to Domestic Law for the Meaning of Undefined Terms*, 17 Intertax 11 (1989), p. 455. Different positions have been taken on the relationship between article 3(2) of the OECD Model and the interpretative provisions of the Vienna Convention. On this debate, *see*, e.g., M.N. Kandev, *Tax Treaty Interpretation: Determining Domestic Meaning Under Article 3(2) of the OECD Model*, 55 Canadian Tax Journal 1 (2007), 38-39. However, Kandev specifies that "[t]he prevailing view today seems to be that Article 3(2) is a special rule in relation to [Vienna Convention on the Law of Treaties] articles 31 and 32 and thus takes precedence over those general rules" (Kandev, 39). *See also* E. van der Bruggen, *Unless the Vienna Convention Otherwise Requires: Notes on the Relationship between Article 3(2) of the OECD Model Tax Convention and Articles 31 and 32 of the Vienna Convention on the Law of Treaties*, 43 Eur. Taxn. 5 (2003), pp. 142-143, Journals IBFD.

"Article 3(2), which is unique to tax treaties,[14] reverses the system on which Article 31 of the Vienna Convention is based. Priority is given to domestic definitions which apply unless a common intention exists based on the treaty context".[15]

As pointed out by Avery Jones and his co-authors, this clearly depends on the structure of the OECD Model. Thus, by quoting the French author Tixier, they clarify: "Tixier makes the point that "double taxation agreements have fundamentally different aims from classic political or economic treaties. They provide links between two tax systems from which they necessarily take their technical vocabulary".

Tax treaties have a greater connection with internal law than most other types of treaty. In most States their effect is to relieve from tax in that State and not to charge tax. *It makes sense therefore if the relieving provisions correspond with the taxing provisions of internal law*".[16]

The structure and functioning of the OECD Model, as reflected in article 3(2), excludes that the occurrence of a tax treaty override is simply a matter of relationship between national and international law in terms of prevalence. The problem is not merely whether an international provision must (or must not) prevail on a domestic one but *how* a treaty provision has regulated the coordination between national and international law. Establishing whether a case of tax treaty override has occurred is essentially a matter of interpretation. It is the agreement, i.e. the will of states, that determines when a tax treaty override occurs. Thus, a treaty can permit unilateral amendments to domestic law by avoiding that these amendments affect the treaty itself (i.e., avoiding that a tax treaty override occurs).[17]

The possibility of an ambulatory interpretation is a clear example of that. As specified above, article 3(2) of the OECD Model establishes the application of domestic definitions under the meaning that they have at the moment of the application of the tax treaty even if these definitions have been amended after the conclusion of the relevant treaty. The OECD Model – through article 3(2) – has established a system under which any subsequent amendment to a national definition is not a treaty override to the extent that the new definition is applied for treaty purposes without exceeding the limits established by the treaty context.[18]

14. *See*, e.g., J.F. Avery Jones et al., *The Origins of Concepts and Expressions Used in the OECD Model and Their Adoption by States*, 60 Bull. Intl. Fiscal Docn. 6 (2006), p. 229, Journals IBFD ("… Art. 3(2) seems to be used only in tax treaties …"); J.F. Avery Jones et al., *The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD Model*, 1 British Tax Review, Part I (1984), p. 16: ("Art. 3(2) appears to be a provision peculiar to tax treaties …").
15. *See* De Pietro, *supra* n. 1, pp. 67-68.
16. *See* Avery Jones et al., *supra* n. 14, p. 17 (emphasis added). *See also* G. Tixier, G. Gest & J. Kerogues, *Droit fiscal international – pratique française*, 12th ed. (Librairies Tecniques (LITEC), 1979), p. 180, where the original French text is contained: "*Or, les conventions fiscales ont un object fondamentalement différent de celui des traités politiques ou économiques traditionnels. Elles constituent des traits d'union entre deux législations fiscales nationales, dont elles empruntent nécessairement le vocabulaire technique*".
17. For example, the fact that the United Kingdom has obtained the inclusion of a provision that preserves the taxing right of the previous state of residence has avoided that the introduction of a re-entry charge (in 1998) and its subsequent amendments (in 2005 and 2013) effected cases of tax treaty override with reference to the tax treaty concluded between Italy and the United Kingdom. *See* De Pietro, *supra* n. 1, p. 175 et seq.
18. The analysis concerning the occurence of a tax treaty override in connection with article 3(2) presupposes the distinction between legislative treaty override and judicial treaty override. In this respect, *see* De Pietro, *supra* n. 1, p. 102: "In connection with Article 3(2), cases of both legislative and judicial tax treaty override may occur. Given the structure and functioning of the OECD Model Convention, in general, and of Article 3(2), specifically, cases of judicial treaty override are certainly more probable. Domestic definitions are, as a rule, adopted to be applied for domestic purposes only. It cannot be said that a tax treaty limits the contracting state's sovereignty in order to amend these definitions. State sovereignty is, however, limited

Thus, the OECD Model requires to build the notion of tax treaty override in terms of coordination and coordination is based on the will of the contracting states.

This is a fundamental conclusion which concerns the structure – and therefore the notion – of tax treaty override but which has effect on its legitimacy as well. In fact, the natural consequence of such an interpretative approach is that, even when subsequent amendments to domestic law affect a tax treaty (i.e., cause a tax treaty override), they are permissible to the extent that the contracting states have agreed on this possibility.[19]

3. An Interpretative Approach which Guarantees Coordination between International Tax Law and Domestic Tax Law

The Dutch Supreme Court has developed an interpretative approach concerning tax treaty override which exactly respects the structure and functioning of the OECD Model. In fact, the Dutch interpretative position is based on the research of the exact balance between international tax law and national tax law as established by the relevant distributive rules. In this respect, the case law concerning notional income and exit taxation is particularly interesting.

3.1. Dutch case law on notional income

As from 1 January 1997, article 12a of the Dutch Wage Tax Act 1964 introduced a so-called "typical-wage rule" (in Dutch: *gebruikelijkloonregeling*). This is an anti-avoidance provision under which a deemed salary is attributed to substantial shareholders of companies where they carry on activities without receiving an appropriate salary, if any. As it is assumed that the shareholders are – in fact – employees of the company, the deemed salary is computed on the basis of what an employee would have received under "normal conditions". This explains the name "typical-wage rule".[20]

In 2003, the Dutch Supreme Court had to examine whether the introduction of a typical-wage rule overrode the tax treaty previously concluded (in 1970) between the Netherlands and Belgium. Two cases[21] were submitted to the Dutch Supreme Court concerning two Belgian individuals who were deemed to have received a salary from Dutch companies.

The tax treaty at issue was based on the OECD Model. Therefore, before 1997, the income that a Belgian resident received from a Dutch company as dividends or capital gains were taxed in the state of residence respectively under article 10 or article 13 of the relevant treaty.

in order to apply amended domestic definitions for treaty purposes in the case of a conflict. Article 3(2), as an interpretative clause, *determines* the application of domestic definitions, in principle destined to apply within the national system, for treaty purposes. Article 3(2) modifies the scope of domestic definitions and actually extends their scope for treaty purposes. As a consequence, tax treaty override may only occur at the moment when an amended domestic definition is *applied* in conflict with the limits established by Article 3(2).
A legislative tax treaty override will be possible only when the scope of domestic law coincides with the scope of a tax treaty already at the moment of its adoption. This usually happens by expressing the intention to override existing tax treaties. In this case, tax treaty override occurs at the moment the domestic law is passed by the national legislature."

19. This is clearly a matter of policy which is up to the contracting states to establish.
20. *See* article 12a of the Dutch Wage Tax Act 1964. Amendments to the typical-wage rule have been introduced after 1997. However, the relevant regime has not been modified substantially.
21. Hoge Raad, 5 September 2003, 37 651; Hoge Raad, 5 September 2003, 37 670.

However, the introduction of a typical-wage rule, which has classified dividends or capital gains received from a company where a substantial shareholder carries on some activities as wage, excluded the application of articles 10 or 13. Instead, articles 15 or 16 of the relevant treaty became applicable. These provisions respectively attributed the right to tax income from employment and directors' fees to the source state.

In fact, the introduction of a typical-wage rule shifted the taxing power from Belgium to the Netherlands by determining the application of articles 15 or 16 of the relevant treaty instead of articles 10 or 13.

According to the Dutch Supreme Court, article 3(2) of the OECD Model allows the application of fictions for treaty purposes, even when they are introduced after the conclusion of the relevant tax treaty. Thus, taxation of notional income is not – in itself – in conflict with article 3(2).

The Dutch Supreme Court argued this position under paragraph 12 of the OECD Commentary on Article 3(2) which grants some "leeway" to national legislatures. When the proper distributive rule applies on the basis of the very nature of the relevant item of income or capital and, therefore, the taxing power is rightly allocated, the national legislature is allowed to regulate "the way of levying the tax, the determination of the time at which the income is taken into account, the determination of the amount of the income, and the way of calculation".[22] Within these limits, and in general within the limits established by article 3(2), national legislation may introduce fictions and tax on a lump-sum basis.

Both articles 15 and 16 of the treaty concluded between Belgium and the Netherlands used undefined terms to be interpreted under article 3(2). In particular, article 15 of this treaty, substantially corresponding to article 15 of the OECD Model, referred to "salaries, wages and other similar remuneration derived by".[23] Article 16 of the same treaty, only partially corresponding to article 16 of the OECD Model, referred to "bonus schemes, attendance remunerations and other remuneration derived by".[24] In principle, both articles 15 and 16 allowed taxation of a fictitious wage which was deemed to be derived from a fictitious employment.

However, the new fictitious classification as wage income determined a shift in the allocation of the taxing power. While dividends or capital gains are taxable in the state of residence under articles 10 or 13, wage is taxable in the state of source. The introduction of the typical-wage rule granted to the Netherlands a taxing power which, before 1997, the relevant treaty recognized to Belgium. This is the consequence of a national fictitious classification of income which disregards the very nature of the income at issue. It gives rise to taxation of a fictitious wage and excludes taxation of real dividends or capital gains.

By introducing the typical-wage rule, the Netherlands determined a unilateral shift in the allocation of the taxing power as established by the relevant treaty at the moment of its conclusion. For this reason the Dutch Supreme Court excluded the right of the Netherlands to apply this legislation for treaty purposes.

22. Hoge Raad, 5 September 2003, 37 651, para. 3.4.1 ("*de wijze van heffing, de bepaling van het tijdstip waarop die inkomsten in aanmerking worden genomen, de bepaling van hun omvang en de wijze van hun berekening*"). *See also*, Hoge Raad, 5 September 2003, 37 670, para. 3.4.1, where the same wording is used.
23. In Dutch: "*Salarissen, lonen en andere, soortgelijke beloningen verkregen door*".
24. In Dutch: "*Tantièmes, presentiegelden en andere beloningen verkregen door*".

This is the interpretative approach on which the case law of the Dutch Supreme Court is based when the attribution of notional income is at issue. Starting point of this interpretative approach is the individuation of the applicable distributive rule on the basis of the very nature of the item of income or capital at issue "as determined by the source from which it arises".[25]

Each relevant distributive rule determines the limits to an ambulatory interpretation in the light of what stated by the OECD Commentary on article 3(2). In particular, an ambulatory interpretation cannot disregard the need to guarantee the "permanency of commitments" mentioned in paragraph 13 of the OECD Commentary on article 3(2). Thus, according to the Dutch Supreme Court, the contracting states cannot make a tax treaty partially inoperative by amending the meaning of its terms through changes to domestic law. This specifically means that an amendment to a national definition which is subsequent to the conclusion of the relevant treaty is not applicable for treaty purposes when it causes a unilateral shift in the allocation of the taxing power in favour of the amending state (i.e. the taxing power of the amending state is unilaterally broadened) and this shift is determined by the application of a distributive rule which is different than the distributive rule applicable on the basis of the very nature of the income or capital at issue.

In other terms, according to the Dutch Supreme Court, a tax treaty override occurs when an amendment to a national definition determines the application of a distributive rule which is different than the distributive rule applicable at the moment of the conclusion of the tax treaty and this new applicable distributive rule recognizes the taxing power to the amending contracting state while the previously applicable distributive rule attributed the taxing power to the other contracting state.

The same interpretative approach was applied by the Dutch Supreme Court in order to verify whether cases of tax treaty override occurred when the Dutch exit tax legislation on substantial shareholding and pension claims was amended in 2001. This interesting case law will be examined below.

3.2. Exit tax on substantial shareholding

The Netherlands introduced an exit tax on substantial shareholding in 1997.[26] This regime was subsequently modified in 2001. Consequently to these amendments, article 4.16 (1)(h) of the Dutch Income Tax Act defines "alienation" as corresponding to the status of being no longer a resident taxpayer. In addition, article 4.46 of the Dutch Income Tax Act establishes that in case of alienation (as defined in article 4.16 (1)(h)), the moment of realization is deemed to be the moment that immediately precedes the moment of no longer being a resident taxpayer.

The amount of tax due at the moment of the transfer is assessed on the basis of a so-called preserving assessment while the payment is postponed until the moment of actual realiza-

25. *See* para. 3.4.1 of both judgments issued on 5 September 2003 ("*zoals die bepaald wordt door de bron waaruit zij ontstaan*").
26. For an overview of the (international) aspects of the Dutch exit tax on substantial shareholding, *see*, amongst others, F.G.F. Peters, *De aanmerkelijkbelangregeling in internationaal perspectief: de exitheffingen en de vestigingsplaatsficties in het licht van de nationale regeling, belastingverdragen, BRK en het EG-recht*, Fiscale Monografieën, vol. 123, (Deventer: Kluwer, 2007).

tion. However, if capital gains are not realized within the period of ten years from the transfer, the Netherlands waives its taxing right.

In February 2009 the Dutch Supreme Court was called upon to decide – in three different cases – whether the exit tax regime on substantial shareholding, as amended in 2001, was compliant with the tax treaties previously concluded with Belgium, the United States and the United Kingdom and based on the OECD Model.[27] The cases at issue regarded three individuals who held a substantial shareholding in a Dutch company and transferred their tax residence to those countries. No question of tax avoidance was raised, which, most probably, would have modified the reasoning of the Court.

This article focuses on the case concerning the tax treaty which was concluded in 1970[28] between the Netherlands and Belgium. The reasoning of the Court in the other decisions was substantially the same.

Article 13(4) of the 1970 treaty between the Netherlands and Belgium followed article 13(5) of the OECD Model. Under this provision, capital gains are only taxable in the state of residence of the alienator.

The Dutch Supreme Court, which followed the Opinion of Advocate General Wattel, excluded that the Dutch exit tax on substantial shareholding, as amended in 2001, gave rise to a case of tax treaty override.[29] The reasoning was exactly the same as developed for the case law on notional income. In his Opinion, Advocate General Wattel pointed out that – according to the case law of the Dutch Supreme Court – the starting point of an evaluation aiming at verifying whether a case of tax treaty override has occurred is the allocation of the taxing power as established by the contracting states at the moment of the conclusion of the relevant tax treaty.

New deeming national definitions may be applied for tax treaty purposes to the extent that the limits established by article 3(2) of the OECD Model are respected. In particular, the application of an amended definition cannot cause a unilateral extension of the taxing power of the amending contracting state by determining the application of a favourable distributive rule which is different from the distributive rule rightly applicable at the moment of the conclusion of the treaty. The rightly applicable distributive rule must be individuated by considering the very nature of the item of income or capital at issue on the basis of its source.

When changing its exit tax regime on substantial shareholding, the Netherlands did not recharacterize the taxable capital gains. Therefore, the 2001 amendments did not determine the application of a distributive rule different than article 13(4), which was the provision originally applicable. However, under article 13(4) only capital gains derived from alienation are taxable. Clearly, in the case at issue the main interpretative question concerned the right to tax accrued and not yet realized capital gains under article 13(4). The solution of this interpretative question required to establish whether the notion of alienation, as used in article 13(4), also included the notion of deemed alienation. Importantly, Advocate General Wattel

27. Hoge Raad, 20 February 2009, 42 701, BNB 2009/260 (Belgium); Hoge Raad, 20 February 2009, 43 760, BNB 2009/261 (United States); Hoge Raad, 20 February 2009, 07/12314, BNB 2009/262 (United Kingdom).
28. A new tax treaty has been concluded between Belgium and the Netherlands which entered into force on 31 December 2002.
29. The author does not agree with the conclusion that an exit tax on substantial shareholding is compliant with article 13(5) of the OECD Model. *See* De Pietro, *supra* n. 1, p. 165 et seq.

pointed out that this examination did not concern a pure fiction, as a real – although not yet realized – economic value was taxable.[30]

The term "alienation" was not defined within the treaty concluded between Belgium and the Netherlands. Therefore, article 3(2) was applicable. The national definition of "alienation", as amended in 2001, could apply for treaty purposes, unless the context otherwise required.

The Dutch Supreme Court excluded that the context required otherwise. It followed the position of Advocate General Wattel according to which the broad scope of the term alienation, as also including deemed realization, can be argued on the basis of paragraphs 5 to 9 of the OECD Commentary on Article 13. In particular, paragraph 8 of the OECD Commentary broadly refers to taxation of capital appreciation, also in case of non-alienated assets. It states: "Special circumstances may lead to the taxation of the capital appreciation of an asset that has not been alienated. This may be the case if the value of a capital asset has increased in such a manner that the owner proceeds to the revaluation of this asset in his books. Such revaluation of assets in the books may also occur in the case of a depreciation of the national currency. A number of States levy special taxes on such book profits, amounts put into reserve, an increase in the paid-up capital and other revaluations resulting from the adjustment of the book-value to the intrinsic value of a capital asset. These taxes on capital appreciation (increment taxes) are covered by the Convention according to Article 2".

Thus, the Advocate General stated that the Commentary on Article 13 allows each contracting state to establish when capital gains can be considered to be realized.

The reasoning of the Advocate General was fully shared by the Dutch Supreme Court according to which by using the term "[g]ains from the alienation of any property" article 13(4) of the treaty between Belgium and the Netherlands also referred to cases of realization other than by alienation. Thus, the Dutch Supreme Court ruled: "4.3.2. Under article 13, § 4 of the Treaty – unless § 5 of that article applies – the gains from the alienation of shares are taxable only in the State of which the alienator is a resident. Article 13, § 4, is included in the Treaty on the basis of the model of article 13, § 5 (until 2003: § 4) of the OECD Model. From the official Commentary on article 13 of the OECD Model, as cited in section 4.13 of the Opinion of the Advocate General, it must be inferred that with the use of the term "gains from the alienation of any property" it is not intended to exclude that a state – with a similar result for the allocation of taxing rights between the contracting states – for the taxation of capital gains alludes to an ascertained accrual of value which has not been effectuated through alienation."[31]

30. The distinction between fictions that are not based on an economic value and fictions that, instead, are like, for example, a lump-sum is clarified in Wattel & Marres, *supra* n. 13, p. 69.

31. Hoge Raad, 20 February 2009, 42 701, BNB 2009/260, para 4.3.2 (author's translation with the assistance of a Dutch native tax lawyer) ("*Ingevolge artikel 13, § 4, van het Verdrag zijn - tenzij § 5 van dat artikel van toepassing is – de voordelen uit de vervreemding van aandelen slechts belastbaar in de Staat waarvan de vervreemder inwoner is. Artikel 13, §4, is in het Verdrag opgenomen naar het model van artikel 13, § 5 (tot 2003: § 4) van het OESO-modelverdrag. Uit het officiële commentaar bij artikel 13 van het OESO-modelverdrag, aangehaald in onderdeel 4.13 van de conclusie van de Advocaat-Generaal, moet worden afgeleid dat niet beoogd is om door het bezigen van de term "gains from the alienation of any property" uit te sluiten dat een staat – met een soortgelijk gevolg voor de verdeling van de heffingsrechten tussen de verdragsstaten – voor de heffing van vermogenswinst aanknoopt bij een geconstateerde vermogensaanwas die niet door vervreemding tot uitdrukking is gekomen.*").

In order to further support their position, Advocate General Wattel as well as the Dutch Supreme Court pointed out that the Dutch regime of exit taxation on substantial shareholding only taxes capital gains accrued during the period of tax residence in the Netherlands. In addition, a step up is granted in case of immigration and double taxation is avoided by recognizing a reverse credit when the state of destination taxes capital gains upon realization.

3.3. Exit tax on pension claims

In June 2009 – only a few months after the judgments on the amended exit tax regime concerning substantial shareholding – the Dutch Supreme Court decided – in three different judgments – on the possibility that cases of tax treaty override were effected by amending the exit tax legislation on pension claims. More specifically, the three cases at issue[32] dealt with the levy of an exit tax on pension rights accrued in the hands of Dutch individuals who transferred their tax residence to France,[33] Korea[34] and the Philippines.[35] The three tax treaties at issue were concluded before 2001, when the Dutch exit tax on pension claims was amended.[36] As a consequence of these amendments, in case of emigration of an employee who had enjoyed pension rights in the Netherlands, the fair market value of these rights was deemed to be income from employment on the basis of a fiction.[37] In addition, this amount was deemed to have been received at the moment immediately preceding the taxpayer's loss of his or her Dutch residence.

Under Dutch legislation, the pension contributions, which are received as part of the salary during the period of employment, are exempted from wage and income taxes during the same period. The pension is taxed at the moment when it is actually paid to the retired employee. Indeed, the paid amount includes both the previously paid contributions and the proceeds of the investment thereof.

Clearly, the Dutch exit tax regime on pension claims has an anti-avoidance purpose. Pension contributions, which are transferred to pension funds during the period of employment in the Netherlands, are exempted from wage and income taxes in the same period in order to be taxed subsequently when the pension is paid in the hands of the Dutch pensioner. However, emigration breaks the balance on which this regime is based. An emigrant taxpayer who has enjoyed previous deductions will be no longer taxable in the Netherlands on the sums received as pension after the transfer of his or her tax residence. Consequently, the payment of an exit tax is required when the taxpayer, after emigration, performs some "tainted actions" as the redemption or alienation of pension claims. A preserving assessment is issued

32. For an analysis of these cases, *see* E.C.C.M. Kemmeren, *Exitheffing bij pensioenen: Financiën is hardleers*, 138 Weekblad Fiscaal Recht 6820 (2009), pp. 881-888; F.P.G Pötgens & H.M. Kappelle, *Over conserverende aanslagen, belastingverdragen en reparatiewetgeving: de geschiedenis lijkt zich te herhalen!* 139 Weekblad Fiscaal Recht 6843 (2010), pp. 74-87.
33. Hoge Raad, 19 June 2009, 43 978, BNB 2009/263.
34. Hoge Raad, 19 June 2009, 07/13267, BNB 2009/265.
35. Hoge Raad, 19 June 2009, 08/02288, BNB 2009/266.
36. The Dutch exit tax regime on pension claims had already been amended before 2001 when measures (different than the measures adopted in 2001) were introduced in order to avoid the abusive application of the regime at issue. However, in two different judgments the Dutch Supreme Court ruled that cases of tax treaty override had been effected. In fact, those amendments had attributed to the Netherlands a taxing power that under Article 18 of the relevant tax treaties could have been recognized only to the new state of residence. See Hoge Raad, 5 September 2003, 37 657, BNB 2003/380 and Hoge Raad, 13 May 2005, 39 610, BNB 2005/233.
37. Article 3.83 of the Dutch Income Tax Act 2001.

in which the tax due at the moment of the transfer is computed. The actual payment is, however, postponed for ten years. If during this period of ten years no tainted action is realized, the Netherlands waives its taxing right.

The Dutch Supreme Court followed the same interpretative approach already developed in the case law on notional income and exit tax on substantial shareholding. Preliminarily, this interpretative approach requires the actual classification of the relevant income in order to establish which distributive rule is properly applicable. The Dutch Income Tax Act classifies the economic value of a pension claim as income from employment.[38] Nevertheless, the Dutch Supreme Court rejected this classification. This depended on the fact that the economic value of a pension claim includes not only the sums transferred to the pension fund but also the proceeds of the investment thereof. Only the sums paid to the pension fund could be classified as income from employment and, therefore, taxed under article 15 of the relevant treaties (article 16 of the treaty with Korea). However, during the period of residence of the employee in the Netherlands these contributions were exempted. Therefore, if pension claims had been taxed, taxation would have been extended to an amount that exceeded the amount of the exempted contributions.[39] In conclusion, in the cases at issue, taxation of an accrued pension claim could not be considered as regulated under article 15 (article 16 of the treaty with Korea) of the relevant treaties. The Dutch Supreme Court ruled that only article 18 (article 19 of the treaty with Korea) was applicable.

According to the Dutch Supreme Court, the application of a tax treaty could not be merely excluded by virtue of the (national) fiction under which the pension claim is deemed to have been received at the moment immediately before emigration. This would be possible only once the compliance of the national provision with the relevant treaties was ascertained.

An in-depth evaluation was conducted by Advocate General Wattel in his Opinion[40] to the case concerning the treaty concluded between France and the Netherlands.[41] In particular, the possible compliance of a preserving assessment on accrued pension claims with article 18 of the relevant treaty was examined. The Advocate General excluded this possibility on the basis of the text and the context of the provision at issue. This provision coincided with article 18 of the OECD Model, under which "pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State". According to the interpretation given by Advocate General Wattel, the term "paid" as used in article 18 of the OECD Model only refers to actual payments. This is confirmed by the OECD Commentary.

The Advocate General did not expressly mention in his Opinion the relevant passages of the Commentary.[42] However, paragraph 7 of the OECD Commentary on Article 10 states that "… [t]he term "paid" has a very wide meaning, since the concept of payment means the

38. This provision has partially been amended in 2009, just after the judgments at issue were delivered. *See* De Pietro, *supra* n. 1, pp. 99-100.
39. Concerning the new Dutch legislation that established the possibility of a preserving assessment based on the amount of pension contributions which were exempted in the Netherlands, *see* De Pietro, *supra* n. 1, pp. 99-100.
40. Opinion of Advocate General Wattel rendered on 31 January 2008 in the "French case" (case nr. 43 978, *see supra* n. 33).
41. The reasoning of the Opinion can, however, be extended to the other cases at issue given their substantial coincidence.
42. *See*, however, Wattel & Marres, *supra* n. 13, pp. 67-69.

fulfilment of the obligation to put funds at the disposal of the shareholder in the manner required by contract or by custom". At the same time, both paragraph 5 of the Commentary on article 11 and paragraph 8.3 of the Commentary on article 12 define the concept of payment as "the obligation to put funds at the disposal of the creditor".

As a consequence, according to Advocate General Wattel, article 18 of the treaty concluded between France and the Netherlands did not allow taxation of accrued pension claims whose amount included not only the contributions to the pension funds, which were exempted in the Netherlands, but also the proceeds of the investment thereof. Under article 18 taxation was only possible at the moment of actual payment of the pension. Therefore, in case of emigration taxation was only allowed in the new state of residence.

In its judgements, the Dutch Supreme Court did not expressly refer to the interpretation of the term "paid". The Court focused on the classification of income on the basis of its real nature and the consequent possibility to apply article 18. The Court recalled its decision in Case 39,610, issued on 13 May 2005, in which it stated that a fictitious classification under national law as income from employment cannot prevent the application of article 18. Only the sums paid by the employer to the employee can be considered as income from employment. After that moment, taxation of pension claims is exclusively governed by article 18. At the same time, a fiction under which pension claims are deemed to be received at the moment immediately preceding emigration cannot exclude the application of article 18. In addition, the Court mentioned its judgment in Case 37,657, issued on 5 September 2003, and ruled that no fiction concerning the moment when the relevant sums are received may modify the fact that article 18 applies and produces its effects only after emigration, when the taxing power is attributed to the new state of residence.

On the basis of this reasoning, according to the Dutch Supreme Court the 2001 amendments to the exit tax regime on pension claims caused the occurrence of tax treaty overrides in the cases under consideration.[43]

4. The Illegitimacy of Treaty Override in a Dualist System: Italy

It is clear from the above that each individual international agreement, as expression of the will of the contracting states, determines when a tax treaty override occurs. The relationship between international tax law and domestic tax law is affected by the relationship between general international law and international tax law. Given the particular structure and functioning of the OECD Model, which is based on limitations to domestic tax law, the occur-

43. It is worth noting that the Dutch Supreme Court has confirmed the importance of the international agreement and the mutual intentions of the treaty partners in some recent case law. In those cases the Dutch Supreme Court dealt with the legitimacy of some Dutch personal income tax provisions in the light of the new double tax treaty between the Netherlands and Belgium. The Dutch Supreme Court rendered decisions in cases about the "typical wage rule" (Hoge Raad, 9 November 2012, 11/02127, BNB 2013/72) and the exit tax on pension claims (Hoge Raad, 15 April 2011, 10/00990, BNB 2011/160). In the case of 9 November 2012 the Dutch Supreme Court attached great importance to the mutual explanatory statement about the interpretation of the various articles in the double tax treaty between the Netherlands and Belgium. It ruled that this statement makes clear that it is the intention of both treaty partners to apply the "typical wage rule" in the context of the double tax treaty. In the case of 15 April 2011 the Dutch Supreme Court considered the changed allocation of taxing rights in the new double tax treaty between the Netherlands and Belgium. Article 18, paragraphs 2 and 3 of this treaty give the source state the possibility to tax pensions under certain conditions and therefore the application of the Dutch exit tax on pension claims does not (necessarily) effects a tax treaty override.

rence of a case of tax treaty override is not merely a matter of prevalence of international law on national law but a matter of coordination (and therefore interpretation). This conception has effect on the legitimacy of treaty override as well. Subsequent amendments to domestic law which affect a tax treaty by modifying it unilaterally are permissible to the extent that the contracting states have agreed on that.

Such a conception allows going beyond a strict opposition between monist and dualist systems.

Traditionally, those states (monist) where international law is considered directly applicable do not allow tax treaty override as international law prevails over national law. On the contrary, those states (dualist) where international law is not considered directly applicable tax treaty override is legitimate. This is the consequence of the fact that an international treaty, in order to apply within the national legal system, must be transformed and incorporated into national law. Therefore, by virtue of the *lex posterior abrogat priori* rule, a subsequent national law of equal rank within the national hierarchy of law can override the previous domestic law incorporating the international treaty. This "mechanism" is absolutely legitimate from a national law perspective. Nevertheless, an international treaty is breached.

In fact, those states that admit tax treaty override do not deny the binding effect of international treaties. However, they do not consider national sovereignty definitively limited by an international agreement. Very interestingly Cassese explains: "This anarchic state of affairs can be easily accounted for: States consider that the translation of international commands into domestic legal standards is part and parcel of their sovereignty, and are unwilling to surrender it to international control. National self-interest stands in the way of a sensible regulation of this crucial area. As a consequence each State decides, on its own, how to make international law binding on State agencies and individuals and what status and rank to assign to it in the hierarchy of municipal sources of law".[44]

In this respect, the Italian constitutional system is particularly interesting. Although Italy is a dualist state and, therefore, international treaties must be transformed and incorporated into national law, treaty override is no longer permissible because an international treaty obligation as such cannot be breached through an amendment to the domestic incorporating law. Italy is a dualist system which preserves international agreements as sources of international obligations.

This result has been obtained through a reform which in 2001 has significantly amended part of the Italian Constitution (Title V). Article 117(1) now expressly mentions international obligations as limits for both the central and the regional legislatures. Consequently to the introduction of this provision, the Italian Constitutional Court has explicitly stated that treaty override is no longer permitted by the Italian constitutional system. A domestic law incorporating an international treaty cannot be amended by a subsequent conflicting law which has the same rank within the national hierarchy of law.[45]

If a case of treaty override is effected, the Italian Constitutional Court must consider illegitimate the domestic overriding law (precisely because it is against article 117(1)) and repeal

44. A. Cassese, *International Law*, 2nd ed. (Oxford University Press, 2005), p. 220.
45. Constitutional Court, judgment 348/2007, paras 4.2-4.3, second part "Considerato in diritto"; Constitutional Court judgment 349/2007, para. 6.2, second part "Considerato in diritto".

it from the Italian legal system. Only in case domestic law is more favourable for taxpayers than international law a conflicting domestic law can prevail over international provisions (under article 169 of the Italian Income Tax Act).[46]

5. EU Law and International Law: Again Treaty Override

The position of states is very much changed with the creation of the European Economic Community (now European Union). Its creation has determined an overlap between the position of a state as EU Member State and its position as a subject of international law. This requires an evaluation of the relationship between legal sources that, beyond the traditional relationship between national and international law, takes into consideration EU law as well and, in particular, the cases of treaty override realized by its amendments.

There is a fundamental difference between, on the one hand, the international legal order and, on the other, the national and EU legal orders. Both the national and the EU legal orders have institutions with representative powers which act on the basis of the attribution of competences. When the relationship between EU Member States and the EU institutions is at issue, this division of competences clearly affects the national sovereignty of the Member States, which is limited in favour of the European Union.

At the international level there are no representative institutions. States act on their own by concluding international agreements which govern their reciprocal relationships. According to Lautepacht, states are at the origin of international law. When their individual behaviours become generally accepted rules, or at least accepted by the majority of states, law is established.

The creation of international law as *Law* is, therefore, based on the consent of states which consider international law generally applicable and binding as *Law*. Thus, according to Lauterpacht, international law is created by states and it is binding exactly because it is expression of the will of states.

Lauterpacht explains: "There is no reason why the original hypothesis in international law should not be that *the will of the international community must be obeyed*. It could be said, by way of further explanation, that although in many cases the will of the international community must be deducted from the mere fact of its existence, i.e. from 'the reason of the thing', *the organs of the formation of the will of the international community are, in the absence of an international legislature, States themselves, their consent being given by custom or treaty, and being capable of impartial ascertainment and interpretation by international tribunals.* An initial hypothesis expressed in the terms of *voluntas civitatis maximae est servanda* would point, as the source of law, to the will of the international society expressing itself in contractual agreements between its constituent members, in their customs, and in the general principles of law which no civilized community can afford to ignore; it would refer to the civitas maxima, as meaning that super-State of law which *States, through the recognition of the binding force of international law qua law, have already recognized as existing over and above the national sovereignties*; it would be compatible with the fact that the authority of that super-State extends, so far, not so much to the creation of new concrete

46. Presidential Decree 917/1986, *Testo Unico delle Imposte sui Redditi*.

rules as to the maintenance and respect of obligations already expressed or contracted by implication".[47]

Indeed, a system based on representative institutions may be much more effective than a system based on individual actions which, as a consequence, lacks a unitary institutional position. This has already been proved with reference to national law. If the relationship is merely among individual states, without institutions unitarily representing them, each state regulates at its discretion the relationship between national and international law. When national law is transformed and incorporated into national law the *lex posterior abrogat priori* rule applies and treaty override is considered legitimate.

The problem of the effectiveness of international law is particularly relevant when EU law is at issue. An EU Member State concludes an international tax treaty with a third state. At the time of its conclusion, the international treaty is fully compliant with EU law. However, after the conclusion of the treaty, EU law is amended and a conflict arises with the previous international treaty. This case is clearly different than the cases dealt with in the *Columbus Container Services*,[48] *Damseaux*[49] and *Levy and Sebbag*[50] decisions. In these last cases a tax treaty override was realized by an amendment to national law decided by the concerned Member State itself.

On the contrary, in the case at issue, an amendment to EU law obliges the concerned Member State to modify national law accordingly. If the Member State does not implement EU law it will be responsible under EU law. On the other hand, if EU law is implemented and a treaty override is actually realized, the concerned Member State will be responsible under international law.

Direct taxation is within the competence of each Member State. However, this is a competence with pre-emption. Every time the EU institutions regulate a certain matter, Member States lose their competence on the specific matter (in favour of the European Union). This is precisely what happened by the adoption of the Parents-Subsidiary Directive,[51] the Merger Directive[52] and the Savings Directive.[53]

In addition, according to a position consistently maintained by the Court of Justice: "As far as the exercise of the power of taxation so allocated is concerned, the Member States nevertheless may not disregard Community rules. According to the settled case-law of the Court, although direct taxation is a matter for the Member States, they must nevertheless exercise their taxation powers consistently with Community law".[54]

47. H. Lauterpacht, *The Function of Law in the International Community* (Oxford University Press, 2011), pp. 429-430 (emphasis added).
48. DE: ECJ, 6 Dec. 2007, Case C-298/05, *Columbus Container Services B.V.B.A. & Co. v. Finanzamt Bielefeld-Innenstadt*, ECJ Case Law IBFD, ECR, I-10451.
49. BE: ECJ, 16 July 2009, Case C-128/08, *Jacques Damseaux v. État Belge*, ECJ Case Law IBFD, ECR, I-6823.
50. BE: ECJ, 19 Sept. 2012, Case C-540/11, *Daniel Levy and Carine Sebbag v. État Belge*, ECJ Case Law IBFD.
51. Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC.
52. Directive 2005/19/EC amending Directive 90/434/EEC.
53. Council Directive 2014/48/EU of 24 March 2014 amending Directive 2003/48/EC on taxation of savings income in the form of interest payments.
54. DE: ECJ, 21 Sept. 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt*, ECJ Case Law IBFD, ECR (1999), I-6161, para. 57. *See also*, amongst others, *Columbus Container Services*, *supra* n. 45, para. 28;UK: ECJ, 12 Dec. 2006, Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue*, ECJ Case Law IBFD, ECR, I-11673, para. 36.

By virtue of the primacy principle, every time an EU law amendment occurs, national law must be modified accordingly, even in matter of direct taxation, although it is, in principle, within the competence of each Member State. This is the result of a position – mostly developed by the Court of Justice – aimed at preserving EU law on the basis of a wide concept of competence.

The role of the Court of Justice has been essential in this respect. When the European Economic Community was founded in 1957 not all the Member States were monist. Therefore, the position very soon taken by the Court of Justice in the *Van Gend en Loos* and *Costa/Enel* cases was extremely courageous and decisive in order to guarantee the integrity of EEC law.

In the *Van Gend en Loos* case, the Court stated: "the task assigned to the Court of Justice under article 117, the object of which is to secure uniform interpretation of the Treaty by national courts and tribunals, confirms that the states have acknowledged that Community law has an authority which can be invoked by their nationals before those courts and tribunals. *The conclusion to be drawn from this is that the Community constitutes a new legal order of international law for the benefit of which the states have limited their sovereign rights, albeit within limited fields, and the subjects of which comprise not only member states but also their nationals*. Independently of the legislation of member states, Community law therefore not only imposes obligations on individuals but is also intended to confer upon them rights which become part of their legal heritage. These rights arise not only where they are expressly granted by the Treaty, but also by reason of obligations which the treaty imposes in a clearly defined way upon individuals as well as upon the member states and upon the institutions of the Community".[55]

A year later, in the *Costa/Enel* case, the Court stated: "By contrast with ordinary international treaties, the EEC Treaty has created its own legal system which, on the entry into force of the Treaty, became an integral part of the legal systems of the Member States and which their Courts are bound to apply".[56]

In fact, these rulings started a process which ended with a limitation of sovereignty in favour of the Community even by states with a long dualist tradition like Italy and Germany.[57]

But, very importantly, the Court of Justice established that EEC law was something other than international law. Indeed, this diversification of EEC law from international law was a preliminary essential step in order to subsequently guarantee its prevalence on international law.

In the relationship with third states, this prevalence has been guaranteed through the development of a concept of implied external competence in conjunction with the concept of competence with pre-emption. In fact, the prevalence of EU (then EEC) law on international law has been guaranteed by legitimizing treaty override within the European Union (then EEC).

55. ECJ, 5 February 1963, C-26/62, *Van Gend en Loos/Administratie der Belastingen*, ECR (1963), para. 1 (emphasis added).
56. ECJ, 15 July 1964, C-6/64, *Costa/E.N.E.L.*, ECR (1964), 585.
57. P. Craig & G. de Búrca (eds.), *The evolution of EU law*, 2nd ed., Oxford University Press, 2011, p. 348 et seq.

Article 351 of the TFEU states: "The rights and obligations arising from agreements concluded before 1 January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of the Treaties". This is the only EU provision which regulates the relationship between EU law and international law. It is worth noting that this provision[58] was already included in the 1957 Treaty of Rome. However, it has always been interpreted very strictly by the Court of Justice. When post-accession treaties are at issue any amendment to EU law which assures competence to the EU institutions will prevail on international treaties concluded before the amendment.

The *Kramer* case[59] concerned the relationship between the then EEC law and the 1959 North-East Atlantic Fisheries Convention which was concluded by the then Member States – except Italy and Luxembourg – and seven non-member countries. This multilateral Convention had the main purpose of protecting the maritime resources of the North-East Atlantic Ocean.

In 1975 some Dutch fishermen breached certain national provisions which the Netherlands had implemented pursuant to a mandatory[60] Resolution made by the North-East Atlantic Fisheries Commission. From the violation of these provisions criminal charges derived against the Dutch fishermen.

The two competent Dutch courts (in Zwolle and Alkmaar) asked the Court of Justice whether the Community had external competence in the matter at issue. This evaluation was considered essential in order to establish whether the relevant Dutch provisions were compliant with Community law.

The reasoning of the Court of Justice in answering the first question has determined a very significant step forward in order to guarantee the effectiveness of Community law vis-à-vis international law. This effect has been obtained precisely by defining a broad concept of external competence as covering the whole system of the Community's objectives. The Court explained: "In the absence of specific provisions of the Treaty authorizing the Community to enter into international commitments in the sphere of conservation of the biological resources of the sea, one must turn to the general system of Community law in the sphere of the external relations of the Community. Article 210 [of the Treaty] provides that 'The Community shall have legal personality'. This provision, placed at the head of Part Six of the Treaty, devoted to 'General and final provisions', means that in its external relations the Community enjoys the capacity to enter into international commitments over the whole field of objectives defined in Part One of the Treaty, which Part Six supplements."[61]

Therefore, according to the Court of Justice, as also confirmed in the Opinion 1/76, the external competence of the Community can be determined implicitly[62] by "other provisions

58. With a different number.
59. ECJ, 14 July 1976, Joined Cases 3, 4 and 6-76, *Cornelis Kramer et al.*, ECR (1976), 1279.
60. Id. at para. 6: "Under Article 8 of the Convention, the Contracting States are obliged to give effect to such recommendations when they have been adopted by not less than a two-thirds majority of the delegations present and voting, subject however to the right of any Contracting State to release itself from this obligation by objecting to the recommendation within a set period."
61. *See Cornelis Kramer et al.*, *supra* n. 59, paras. 16, 17/18.
62. ECJ, Opinion 1/76, of 26 April 1977, ECR (1977), 741, para. 3.

of the Treaty, … the Act of Accession and … measures adopted, within the framework of those provisions, by the Community institutions".[63]

At the time of the relevant facts, the Community had already assumed internal competence on the matter by adopting legislation concerning a common fisheries policy. Nevertheless, the Community had not yet "fully exercised its functions in the matter"[64] and, therefore, at that time the Member States still had the right to undertake and, therefore, implement international obligations. However, very importantly the Court concluded: "… it should be stated first that this authority which the member states have is *only of a transitional nature*[65] and secondly that the member states concerned are now bound by Community obligations in their negotiations within the framework of the Convention and of other comparable agreements".[66]

In the *Arbelaiz-Emazabel* case[67] the external competence of the Community was defined by establishing the prevalence of an interim regime on a post-accession international treaty.

Arbelaiz-Emazabel was the master of a Spanish vessel which was found to fish between six and twelve miles from the French coast without a licence, in breach of article 3 of Regulation No. 2160/1977. For this reason criminal proceedings started in France against him.

The above-mentioned regulation was part of the interim legislation applicable during the negotiations between Spain, which at that time was still a non-member country, and the Community on conservation of fisheries resources. This interim legislation extended up to 200 miles from the coast the expanse of ocean within which a licence was required in order to fish.

However, the provision at issue was in conflict with a previous international agreement concluded in 1967 between France and Spain (within the framework of the 1964 London Fisheries Convention) which allowed fishing between 6 and 12 miles without any licence.

The French Court of Cassation submitted the question for a preliminary ruling to the Court of Justice and asked whether the Community interim regime could be considered applicable to Spanish fishermen although this regime was in conflict with a previously concluded international agreement which was still in force at the time when the relevant facts happened.

The Court of Justice, by quoting the *Kramer* case, highlighted that the Community had already acquired internal competence in matter of protection of fishing resources and that, in order to pursue this internal objective, the external competence of the Community was established as well.[68]

In the *Kramer* case the Court specified that when the relevant facts arose the Member States still had the right to undertake – and therefore to implement – international obligations in matter of protection of marine resources. This right existed because at that time the

63. *See Cornelis Kramer et al.*, *supra* n. 59, paras 19-20.
64. *See Cornelis Kramer* et al., *supra* n. 59, para. 39.
65. Emphasis added.
66. *See Cornelis Kramer* et al., *supra* n. 59, para. 40.
67. ECJ, 8 December 1981, C-181/80, *Arbelaiz-Emazabel*, ECR (1981), 2961. *See*, R.R. Churchill & N.G. Foster, *European Community Law and Prior Treaty Obligations of Member States: The Spanish Fishermen's Cases*, 36 The International and Comparative Law Quarterly 3 (1987), pp. 504-524.
68. *See Arbelaiz-Emazabel*, *supra* n. 67, para. 8.

Community had not yet "fully exercised its functions in the matter".[69] However, according to the Court of Justice, the Spanish government collaborated in order to implement the interim regime. This government was, therefore, clearly aware of the content of the interim provisions, subsequently introduced in the agreement between Spain and the Community.[70]

In addition, the Court pointed out: "it should be observed in the first place that art. 10 of the London Convention prescribes that no provision thereof is to prevent the establishment of a special regime in matters of fisheries as between member States of the Community, whilst art. 5 allows coastal states, in certain circumstances, to enforce conservation measures within the 6 to 12-mile zone".[71]

According to the Court, it is clear from the above-mentioned provisions that the parties to the London Fisheries Convention were aware of the existence of commitments between the Member States and that they had already recognized the need to implement measures in order to protect the marine resources in the same area covered by the Convention. The parties to the Convention must have, therefore, expected that the Community institutions would have exercised the power to implement conservation measures under the above-mentioned article 5.[72]

Thus, the Court of Justice concluded: "[t]hose relations, which were confirmed by the agreement on fisheries concluded between the Community and Spain and were progressively developed with the concurrence of the Spanish authorities following the decisions which the Community and the Member States thereof adopted in 1976 in order to deal with the increasingly urgent need to conserve the living resources of the sea and to take into account the general evolution of international law in the field of sea fishing, *replaced the prior international obligations* existing between certain Member States, such as France and Spain".[73]

It is clear from the above that when post-accession treaties are at issue, the position of the Court of Justice guarantees the prevalence of EU law on international law every time EU law is amended. This prevalence has been established by legitimating treaty override. In such cases the consequences for third states are grave. No protection is guaranteed to their rights (and economic interests).

The jurisdiction of the International Court of Justice is only consensual. This means that in order to start proceedings before it, all the involved parties must accept its jurisdiction. In addition, at the international level there is no real system of sanctions. In fact, the international legal order has no means that can actually guarantee its prevalence. This is a grave damage for its effectiveness. But – most importantly – its lack of effectiveness is a grave damage for economic operators (taxpayers) acting globally.

69. *See Cornelis Kramer* et al., *supra* n. 59, para. 39.
70. *See Arbelaiz-Emazabel*, *supra* n. 67, paras. 27, 28, 29 and 30.
71. Id., para. 12.
72. Id., para. 13.
73. Id., para. 30 (emphasis added).

This lack of effectiveness is particularly relevant in times when the OECD – through its so-called BEPS actions[74] – and the European Union[75] are both working on different measures against tax avoidance and tax evasion. A lack of institutional coordination between the OECD and the European Union could represent an important obstacle to the actual implementation of the new international measures[76]

Most importantly, even if the European Union and the OECD could find an agreement, the OECD would have no certainty for the future. The position of the Court of Justice on the European Union competence does not give any guarantee that cases of treaty override will not occur.

6. Conclusive Remarks: Coordination as a Guarantee of Effectiveness and Legal Certainty

Under general international law, the relationship between international and national law is conceived in terms of prevalence of the first on the other, i.e. international law applies instead of national law. However, international tax law (specifically, the OECD Model) reverses the relationship between international and national law: national tax law applies, although within the limits established by international formal distributive rules.

Clearly, the notion of tax treaty override cannot be conceived in the traditional monist or dualist terms. The OECD Model requires integration (i.e. coordination) between national

74. OECD Ctr. for Tax Policy and Admin., *Action Plan on Base Erosion and Profit Shifting* (OECD 2013) International Organizations' Documentation IBFD, available at http://www.oecd.org/ctp/BEPSActionPlan.pdf.

75. European Commission, Communication from the Commission to the European Parliament and the Council: An Action Plan to strengthen the fight against tax fraud and tax evasion, available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_fraud_evasion/com_2012_722_en.pdf. *See also* European Commission, Commission Recommendation regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters, C(2012) 8805 final (6 December 2012), available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_fraud_evasion/c_2012_8805_en.pdf; European Commission, Commission Recommendation on aggressive tax planning, C(2012) 8806 final (6 December 2012), available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_fraud_evasion/c_2012_8806_en.pdf.

76. In fact, the OECD has expressly recognized that EU law can be an obstacle to the full implementation of its proposals in matter of BEPS. See, for example, OECD, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, 2014, available at http://www.oecdilibrary.org/docserver/download/2314281e.pdf?expires=1423212065&id=id&accname=guest&checksum=BAB79D15C5F794BD32885C3911C52F35, p. 19: "6. When examining the model treaty provisions included in this report, it is also important to note that these are model provisions that need to be adapted to the specificities of individual States and the circumstances of the negotiation of bilateral conventions. For example:

   – *Some countries may have constitutional or EU law restrictions that prevent them from adopting the exact wording of the model provisions that are recommended in this report* (emphasis added).

   … For these reasons, a number of the model provisions included in this report offer alternatives and a certain degree of flexibility. There is agreement, however, that these alternatives aim to reach a common goal, i.e. to ensure that States incorporate in their treaties sufficient safeguards to prevent treaty abuse, in particular as regards treaty shopping. For that reason, the report recommends a minimum level of protection that should be implemented (see paragraph 14 below)".

   However, this minimum level of protection seems to be quite low. Further (on p. 23) it is stated: "14. As long as the approach that countries adopt effectively addresses treaty abuses along the lines of this report, some flexibility is therefore possible. At a minimum, however, countries should agree to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements (*see* Section B)".

and international tax law. Opportunely, Garbarino explains: "Tax treaties complete and presuppose domestic law …".[77]

The problem is not merely one of prevalence of international tax law on national tax law. The problem is rather *how* international and national tax law must be coordinated.

Tax treaty override occurs when the delicate balance between international tax law and domestic tax law, as established by the distributive rules of the OECD Model, is disrupted. The international agreement, therefore, defines a tax treaty override. When an ambulatory interpretation takes place under article 3(2) of the OECD Model, a treaty override is avoided to the extent that the application of the new national definition does not exceed the limits established by the treaty context. Under this conception, that recognizes the agreement as the means to define tax treaty override, the will of the contracting states has effect on the legitimacy of treaty override as well. Subsequent amendments to domestic law which affect a tax treaty by modifying it unilaterally are permissible to the extent that the contracting states have agreed on that.

This conception clearly reflects the characteristics of the international legal system which has no representative organs and is still founded on the individual action of states. They regulate their reciprocal relationships by concluding international treaties. States are "creators" of law, in the sense that they realize those material behaviours which, once accepted by the majority of them, become law. According to Lauterpacht, international law is objectively binding exactly because it is expression of the will of states.

The creation of the European Economic Community, now European Union, had a high incidence on the position of states. It has determined an overlap between the position as EU Member States and the position as subjects of international law. When an EU Member State concludes a tax treaty, it acts as a subject of international law because direct taxation is within the competence of each Member State. However, this is a competence with preemption and, therefore, every time the European Union regulates a certain matter there is an extension of its competence.

The role of the Court of Justice has been fundamental in order to resolve the overlapping of the two legal systems by assuring the prevalence of EU (previously EEC and EC) law on international law. Already a few years after its creation, the EEC legal order was distinguished from the international one. In the *Van Gend en Loos* case, the Court ruled: *"the Community constitutes a new legal order of international law for the benefit of which the states have limited their sovereign rights …"*.[78] A year later, in the *Costa/Enel* case, the Court reiterated the ruling: "By contrast with ordinary international treaties, the EEC Treaty has created its own legal system …".[79]

The emancipation of the EEC legal order from the international one has been a fundamental step in order to guarantee its prevalence. Article 351(1) of the TFEU establishes that "[t]he rights and obligations arising from agreements concluded before 1 January 1958 or,

77. C. Garbarino, *Manuale di tassazione internazionale*, 2nd ed. (IPSOA Wolters Kluwer Italia, 2008), p. 194 (author's translation: "… *un'interpretazione delle Convenzioni contro le doppie imposizioni che prescinda totalmente dalla legislazione interna non é attuabile in concreto. Le Convenzioni fiscali completano e presuppongono le legislazioni nazionali …*").
78. *See Van Gend en Loos/Administratie der Belastingen*, *supra* n. 55, para. 1 (emphasis added).
79. *See Costa/E.N.E.L.*, *supra* n. 56.

for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of the Treaties".

Thus, only international treaties already concluded before the creation of the EEC or the accession of a new Member State can prevail on EU law. In any other case a subsequent amendment to EU law which gives rise to a conflict with an existing international treaty will prevail. The Court of Justice has, in fact, legitimized treaty override within the European Union.

The result is that when an EU Member State implements an EU law amendment which is in conflict with a previously concluded international treaty, the rights of the third state which is a party to the breached agreement are gravely compromised because the international legal system has not developed measures appropriate in order to guarantee protection. The jurisdiction of the International Court of Justice is only consensual and no real system of sanctions exists. Indeed, this highly compromises economic operators (i.e. taxpayers) acting globally.

This is particularly relevant in this period, when both the OECD and the European Union are working on the implementation of anti-avoidance and anti-evasion measures. A lack of institutional coordination between the OECD and the European Union could represent an important obstacle to the actual implementation of the new international measures. Even more importantly, should the Court of Justice effect cases of treaty override, the effectiveness of the OECD measures could be gravely compromised in the future.

It is clear, therefore, that coordination – in this case between international and EU law – is again the solution. This coordination could (and should) be guaranteed through the combined action of the OECD and the EU institutions in order to guarantee taxpayers protection and, more broadly, legal certainty.