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Squaring the Circle : The Role of the OECD Commentaries For the Interpretation of Tax Treaties Between the OECD and non-OECD States

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Abbreviations

OECD – Organisation for Economic Co-operation and Development

CFA - OECD's Committee of Fiscal Affairs

Vienna Convention - Vienna Convention of 23 May 1969 on the Law of Treaties

UK- United Kingdom

EU- European Union

WTO- World Trade Organisation

1. Introduction

1.1 Background

The expansion of the OECD mandate to non-OECD economies in taxation area is prevalent and is caused as well as by demand of global economy and the OECD's desire to adjust the new rule to the new realities also by increasing role of the non-OECD world.¹

The OECD Model and commentaries have had a great influence in fiscal negotiations between OECD and non-OECD economies.² While concluding tax treaties based on the OECD Model jurisdictional winners are usually residence (mostly OECD) states achieving capital export neutrality, tax treaties can also be important and beneficial for capital-importing (mostly non-OECD) states.³ As it is indicated by the Indian supreme court, developing states often tolerate with unfavourable tax treaty terms and loss of revenue in order to attract foreign direct investments.⁴ Moreover, it is argued that *“from the perspective of source country the most important function of a tax treaty may be its role as a significant device, indicating to potential investors that the capital-importing nation is playing by the conventional international investment rules and is part of the global economy”*⁵

Non-OECD economies in the areas of negotiation, application, and interpretation of tax treaties have to cope with similar problems as the OECD states and can therefore benefit from the OECD's contribution.⁶ As the OECD model has been used by everyone the OECD should ensure that treaties are interpreted in the same way not depending on the fact whether the state is the OECD member or not.⁷ It is indicated in the OECD commentaries that as far as the OECD accepted ambulatory interpretation of the commentaries, which can also trigger non-OECD member states, the CFA decided to involve non-OECD countries to benefit from their input.⁸ From 1997 certain non-member countries can indicate their official position about the OECD Model and commentaries and currently there are 31 non-OECD economies that set their official position about the OECD model and its commentaries.⁹ Working party #1 of CFA, which purpose is to involve non-OECD members in working process on issues of double taxation, includes work on OECD documentations in order to promote evolution of tax treaties by making them more flexible.¹⁰ This working party can now react more urgently to newly appearing problems, making the OECD Model more topical and dynamic.¹¹ Apart from this a lot of activities have been held by CFA in the non-OECD countries to ensure more involvement of the non-OECD countries in the OECD activities.¹²

1 Ken Messere, “Expansion of the OECD's Tax Activities” Bulletin, february 2003, IBFD p.75

2 Christiana HJI Panayi “Double Taxation, Tax Treaties, Treaty-Shopping and the European Community” EUCOTAX Series on European Taxation, 2007 Kluwer Law International p. 25

3 Fabian Barthel, Mathius Busse, Richard Krever and Eric Neumayer “The Relation between double Taxation Treaties and Foreign Direct Investments” - Tax Treaties Building Bridge between Law and Economics IBFD december 2010

4 Union of India vs Azadi Bachao Andolan (2003) 263 ITR 706 (SC)

5 Fabian Barthel, Mathius Busse, Richard Krever and Eric Neumayer “The Relation between double Taxation Treaties and Foreign Direct Investments” - Tax Treaties Building Bridge between Law and Economics IBFD december 2010

6 Ken Messere, “Expansion of the OECD's Tax Activities” Bulletin, february 2003, IBFD p.76

7 John Avery Jones, “Are tax treaties necessary” 53 Tax L.Rev 1 1999-2000 p.2

8 Introduction on the OECD Model Tax Convention on Income and Capital 2010 paragraph 10

9 Ibid

10 Ken Messere, “Expansion of the OECD's Tax Activities” Bulletin, february 2003, IBFD p.77

11 Prof. Dr Klaus Vogel “The Influence of the OECD Commentaries on Treaty Interpretation” Bulletin- Tax Treaty Monitor, December 2000 p.617

12 For details see: Ken Messere, “Expansion of the OECD's Tax Activities” Bulletin, february 2003, IBFD p.76

1.2 Problem Description

The use of the OECD Commentaries for the interpretation of the tax treaty in the non-OECD Legal order is observed. For example, there are tax treaties between non-OECD and OECD countries which directly refer to the commentaries.¹³ Furthermore, the Courts use commentaries for their interpretative purposes, as well as taxpayers and tax authorities for their argumentations. The OECD Commentaries is considered to be a best international practice in the field of international taxation, which sometimes even referred as “international tax language”¹⁴

The Commentaries can be a useful tool for tax treaty interpretation:

1. when there is no definition of the term in the treaty and domestic law definition of the term is the same as the definition of the OECD Model
2. when there is same definition of the term according to the tax treaty and OECD Model¹⁵.
3. when a tax treaty requires a uniform interpretation.¹⁶
4. when according to the Article 3(2) of the OECD Model, “context requires otherwise”¹⁷

At the same time, there is no legal certainty to what extent the Commentaries are binding in tax treaty interpretation process. Some scholars consider the problem of Commentaries' legal status as the major unsolved problem in international tax law.¹⁸

Difficulties of international agreements' interpretation arise because their interpretation should be generally distinguished from the interpretation of domestic laws. This includes using elements of comparative law, such as looking to other states' domestic laws and treaty case laws.¹⁹ Vogel points out that the most supported view is that treaty obligation should be interpreted restrictively as “*parties to a treaty in doubtful cases should only be presumed to have waived their sovereignty to the extent that is unequivocally apparent from the text of the treaty*”²⁰ When it comes to particularities of tax treaties the picture becomes more complicated. It is important to acknowledge that tax treaties are not conflict rules and thus they differ from rules of private international law--tax treaties themselves do not lay down norms for choosing between domestic and foreign jurisdiction. Instead, they provide an independent mechanism to ensure avoidance of double taxation. In other words, tax treaties “*lay down boundaries of domestic taxation, without creating new taxing rights for government*”²¹ The fact that treaties are based on the principle of reciprocity

13 See for example: Georgia-Austria Double Tax Treaty , Conclusion Date 11 April, 2005
http://english.bmf.gv.at/Tax/DoubleTaxationAgreements/TheAustrianTaxTreat_271/GeorgienE.pdf and Georgia-Denmark Double Tax Treaty, Conclusion Date 10 October, 2007
<https://www.retsinformation.dk/Forms/R0710.aspx?id=122141>

14 Prof. Dr Klaus Vogel “The Influence of the OECD Commentaries on Treaty Interpretation” Bulletin- Tax Treaty Monitor, December 2000 p.617

15 HMRS vs. Smallwood and Another {2010} EWCA CIV 778 paragraph 98

16 Klaus Vogel on Double Taxation Conventions, Third Edition, A Commentary to the OECD, UN and U.S. Model Conventions for the Avoidance of Double Taxation of Income and Capital, With Particular Reference to German Treaty Practice, Kluwer law international, 1997 p.43

17 Maarten J.Ellis “The Influence of the OECD Commentaries on Treaty Interpretation – Response to Prof. Dr Klaus Vogel” Bulletin- Tax Treaty Monitor, december 2000

18 Monica Erasmus-Koen and Sjoerd Douma “ Legal Status of the OECD Commentaries – In Search of the Holy Grail of international tax law” Tax Treaty Monitor, Bulletin for international taxation August 2007 p.339

19 Klaus Vogel on Double Taxation Conventions, Third Edition, A Commentary to the OECD, UN and U.S. Model Conventions for the Avoidance of Double Taxation of Income and Capital, With Particular Reference to German Treaty Practice, Kluwer law international, 1997 p. 34-35,

20 Ibid p.39

21 Christiana HJI Panayi “Double Taxation, Tax Treaties, Treaty-Shopping and the European Community” EUCOTAX

and is the result of conflicting negotiation should also be taken into account.²²

The main problem to determine legal status of the Commentaries and therefore to find out to what extent a domestic judge is bound by the Commentaries interpreting tax treaties is the interrelation of the Commentaries with the general rule of interpretation of treaties according to articles 31 and 32 of the Vienna convention²³

To paraphrase Avery Jones, the main issue is not whether or not the Commentaries is important but *“how much weight should be given to them in any particular situation”*²⁴

1.3 Purpose

The purpose of this thesis is to shed some light into the issue questioning the role and legal status of the Commentaries for tax treaty interpretations between OECD and non-OECD states in order to assess the role of the Commentaries and to determine to what extent Courts are bound by the Commentaries interpreting tax treaties between OECD and non-OECD countries.

1.4 Outline

This thesis is divided into six sections. The first section is the Introduction. The second section discusses the legal status of the Commentaries for interpretation of tax treaties concluded between OECD and non-OECD under the Vienna Convention with reference to legal debates and to case law. The third section highlights the problem of ambulatory and static interpretation of the OECD Commentaries; the problem is discussed with reference to legal debates and relevant case law. The fourth section concentrates on case law analysis about role of the Commentaries which it plays in non-OECD states in order to determine how the court considers the Commentaries. The fifth section discusses the particularities of using of “foreign law” in different national legal orders and how these particularities can influence the tax treaty interpretation process. The sixth section will draw the final conclusions.

1.5 Delimitations

The author of the thesis acknowledges that the whole picture about the role of the OECD Commentaries for the interpretation of tax treaties between non-OECD and OECD countries can not be discussed without a case by case analysis of tax treaty case law and domestic legislations of the countries. Therefore, this thesis will only discuss a general picture. This thesis will try to shed some light on the role of the Commentaries in tax treaty interpretations between OECD and non-OECD countries. While the scholars discussing the legal status of the Commentaries mostly discuss the role of the Commentaries for the interpretation of tax treaties between OECD states,²⁵ the issue

Series on European Taxation, 2007 Kluwer Law International p.18

22 Klaus Vogel on Double Taxation Conventions, Third Edition, A Commentary to the OECD, UN and U.S. Model Conventions for the Avoidance of Double Taxation of Income and Capital, With Particular Reference to German Treaty Practice, Kluwer law international, 1997 p.50

23 Monica Erasmus-Koen and Sjoerd Douma “ Legal Status of the OECD Commentaries – In Search of the Holy Grail of international tax law” Tax Treaty Monitor, Bulletin for international taxation August 2007 p.340

24 Dr. John F. Avery Jones “The Effects of Changes in the OECD Commentaries after a Treaty is Concluded” Bulletin – Tax treaty Monitor, March 2002 p.103

25 See inter alia, Monica Erasmus-Koen and Sjoerd Douma “ Legal Status of the OECD Commentaries – In Search of the Holy Grail of international tax law” Tax Treaty Monitor, Bulletin for international taxation August 2007 , Frank Engelen “Some Observations on the Legal Status of the Commentaries on the OECD Model” Bulletin – Tax Treaty

of the role of the OECD Commentaries for tax treaty interpretations between OECD states or only non-OECD states will be triggered only as far as it is important to achieve goals set by this thesis. While there are tax treaties between OECD and non-OECD countries that follow the UN Model²⁶, discussing the role and legal status of the OECD Commentaries, this thesis relies on the assumption that tax treaties follow the OECD model. The case law discussed in this thesis does not always represent the view of the highest courts of the states and therefore cannot always be considered as “settled case law”. However they are also discussed in order to draw a current picture and highlight controversies in the application of Commentaries.

1.6 Methods and Materials

The thesis will analyze different sources of law and materials, such as international agreements, documents of international organizations, case law and scholars' articles in order to assess the role of the Commentaries for tax treaty interpretation between OECD and non-OECD states. The elements of comparative studies and comparative methods will also play a significant role in achieving the goal of this thesis. The choice of case law is based on research of the IBFD tax treaty case law database and on the accessibility of cases as well as on the relevance of the case law for the topic discussed in this thesis. All cases were read in their original versions unless otherwise indicated in this thesis.²⁷ The thesis uses materials that were accessible until 25.05.2012.

2. Legal Status of the OECD Commentaries under the Vienna Convention

While the Vienna Convention contains only general rules of application and does not take into consideration the particularities of tax treaties, currently the Vienna Convention is actively used for the interpretation of tax treaties even in the countries that have not yet ratified the convention.²⁸ As it is fairly argued, the Vienna convention is the codification of customary rules of international law and therefore should be applicable not only in the countries that have ratified the Vienna Convention.²⁹

2.1 The Nature of the OECD Commentaries and Countries Observation on OECD Commentaries

The introduction of the OECD Commentaries clearly states that OECD members do not want to be legally bound by the Commentaries. As it is indicated in the Commentaries “*Although the Commentaries are not designed to be annexed in any manner to the conventions signed by member countries, which unlike the Model are legally binding international instruments, they can nevertheless be of great assistance in the application and interpretation of the conventions and, in particular, in the settlement of any disputes*”³⁰. While under the customary law it is possible for a non-binding recommendation to transform into legally binding norm, the practice of application of

Monitor March 2006, Petter J. Wattel and Otto Morres “The legal Status of the OECD commentary and static or Ambulatory interpretation of Tax Treaties” European taxation, July/August 2003

26 <http://www.un.org/esa/ffd/tax/unmodel.htm>

27 See For example, See footnote 143

28 Klaus Vogel on Double Taxation Conventions, Third Edition, A Commentary to the OECD, UN and U.S. Model Conventions for the Avoidance of Double Taxation of Income and Capital, With Particular Reference to German Treaty Practice, Kluwer law international, 1997 p.35

29 Ankit Virenda Sudha Shash “The Legitimacy of Reference to OECD Commentary for interpretation of Income Tax Act and DTAAs” february 2012 see on: <http://www.bcasonline.org/articles/artin.asp?1035>

30 Introduction on the OECD Model Tax Convention on Income and Capital 2010 paragraph 29

the Commentaries in OECD member states as well as the lack of belief by the member states that Commentaries are legally binding make it difficult to argue that Commentaries is a binding instrument according to international customary law.³¹ Pijl concludes “*a practical recourse for common reference to a mutually understandable vocabulary book, which suggests possible solutions. Asking more from the Commentary than this would be exaggerating the expectations of what the Commentary can currently achieve*”³² As it is indicated in the current development, the OECD legal order does not resemble the requirements of the globalization³³ -- while taxpayers have become global, tax authorities do not follow them.³⁴

The OECD member states as certain non-OECD members set an official position on the Commentaries. The Commentaries about non-member countries' position states that “*these countries generally agree with the text of the Articles of the Model Tax convention and with the interpretations put forward in commentaries*” and set their position in case of disagreement with the interpretation given by the commentaries to articles of the Model tax convention.³⁵ China and Indonesia admit that these positions can not be binding for them in the process of negotiation and application of tax treaties.³⁶

The fact that treaties are generally silent about the observations can cause some difficulties and raise issues in the treaty interpretation process.³⁷ The OECD Model and Commentaries do not contain any guidance about the role of the observations either.³⁸ The main difficulties are connected to the problem of legal characterization of these observations. While one can ask why it is necessary to make reservations if they are not even potentially binding³⁹, it should be highlighted that observations on Commentaries are of unique nature and observations differ from unilateral declarations as they are made on Commentaries which is generally a non-binding document.⁴⁰ The other problem is that countries are not consistent with their positions set in observations⁴¹ For example, as it is admitted, publicly available data show that states sometimes do not make observations even if they disagree with Commentaries.⁴²

When discussing the legal status of the Commentaries according to public international law, these circumstances should be taken into account.

31 Monica Erasmus-Koen and Sjoerd Douma “ Legal Status of the OECD Commentaries – In Search of the Holy Grail of international tax law” Tax Treaty Monitor, Bulletin for international taxation August 2007 p.342

32 Hans Pijl, “The OECD Commentary, As a Source of International Law and the Role of the Judiciary” European taxation, May 2006 p.221

33 Ibid p.347

34 John F.Avery Jones “Are Tax Treaties Necessary” 53 Tax L.Rev 1 1999-2000

35 OECD Model Tax Convention on Income and Capital 2010, Non-OECD economies position on commentaries, introduction, paragraph 5

36 Ibid

37 Guglielmo Maisto “The Observations on the OECD Commentaries in the Interpretation of tax treaties” Bulletin-Tax Treaty Monitor, January 2005 p.14

38 David A Ward, “The role of the Commentaries on the OECD Model in the Tax Treaty Interpretation” Bulletin – Tax Treaty Monitor March 2006 p.100

39 Monica Erasmus-Koen and Sjoerd Douma “ Legal Status of the OECD Commentaries – In Search of the Holy Grail of international tax law” Tax Treaty Monitor, Bulletin for international taxation August 2007 p.347

40 Guglielmo Maisto “The Observations on the OECD Commentaries in the Interpretation of tax treaties” Bulletin-Tax Treaty Monitor, January 2005 p.14

41 Ibid p.19

42 Monica Erasmus-Koen and Sjoerd Douma “ Legal Status of the OECD Commentaries – In Search of the Holy Grail of international tax law” Tax Treaty Monitor, Bulletin for international taxation August 2007 p.347

2.2 Article 3(2)

While the Article 3(2) of the OECD Model and its Commentaries does not mention the Vienna Convention⁴³, Prof. Maarten J. Ellis fairly suggests that before determining the status of the Commentaries under public international law, and particularly under the Vienna Convention, firstly it should be discussed what place the Commentaries has under the Article 3(2) of the Model.⁴⁴

The exact function of the Article and its relation with the rules of interpretation of Vienna Convention is debatable.⁴⁵

According to the Article 3(2) of the Model, terms that are not defined by the treaty should have the meaning which they have according to domestic law of the party applying the treaty unless “context otherwise requires”. In this regard, the wording “unless context require” can be misleading, creating a closed circle effect by indirectly referring back to the Commentaries.

As J. Ellis contends the questions that come immediately are: whether or not the OECD Commentaries is “context” and how strong is “requires”⁴⁶

While there are some scholars supporting the idea that the Article 3(2) of the Model constitutes *lex specialis* and thus excludes the possibility of using the Vienna Convention's rules of interpretation, Bruggen points that the Article 3(2) can only be interpreted with references to the Vienna Convention.⁴⁷ Specifically, the Vienna Convention can be helpful to answer the question-- what is the context. At the same time Avery Jones suggests that the context can not be limited by the Article 31(2) of the Vienna Convention and should include all rules of interpretation of the international treaties.⁴⁸

In regards to the wording “requires” there is no clear position. One can argue that internal law definition should be used only in the case when no context of the treaty exists. At the same time there is an argument that the history and development of the Article 3(2) implies that the definition which is contrary to the definition of domestic law should only be used in exceptional situations⁴⁹. Avery Jones agrees with Vogel and suggests that in general internal law definition should be used, unless the context is strong enough to override domestic law and the strength of the “context” should be determined on case-by-case basis without attempting to find some general hierarchical approach.⁵⁰

43 Edwin 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 the Treaties” European taxation, March 2003, p.

44 Maarten J.Ellis “The Influence of the OECD Commentaries on Treaty Interpretation – Response to Prof. Dr Klaus Vogel” Bulletin- Tax Treaty Monitor, december 2000

45 Edwin 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 the Treaties” European taxation, March 2003 p.142

46 Maarten J.Ellis “The Influence of the OECD Commentaries on Treaty Interpretation – Response to Prof. Dr Klaus Vogel” Bulletin- Tax Treaty Monitor, december 2000 p.617

47 Edwin 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 the Treaties” European taxation, March 2003. p 155-156

48 John F. Avery Jones “The interpretation of tax treaties with particular reference to article 3(2) of the OECD Model” Reprinted from The British Tax Review 1984 #1 and 2, p.104

49 Ibid p.106-107

50 Ibid p.108

Some guidance to determine when context does require otherwise can also be found in Commentaries to the Article 3(2), which states that the “context otherwise requires” when:

1. one of the parties makes substantial changes in the domestic laws making the convention inoperative
2. using of domestic concept is outdated⁵¹

With this regard, it can be concluded that the purpose of the wording “unless context otherwise requires” also is to ensure effective application of the treaty in the light of dramatically changing world and at the same time to avoid the abuse of the right by only one contracting party amending its internal law unilaterally.

2.3 Vienna Convention - Treaty between non-OECD States with official position and OECD States

According to the Article 31(1) of the Vienna convention “*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 objective and purpose*” As it is indicated this Article includes three principles in it:

1. the principle of good faith that directly linked to the principle of *pacta sunt servanda*.
2. Interpretation based on the ordinary meaning opposed to the special meaning
3. The rule that ordinary meaning should be determined taking account context, object and purpose of the treaty.⁵²

Furthermore as it is submitted the Article does not provide any hierarchical rule about priority of these principles, in thus the Article suggests to combine all this principle while interpreting the treaty.⁵³

2.3.1 Good faith

When it comes to the interpretation of the tax treaty “ordinary meaning” should usually be the meaning given by the treaty or domestic law. According to the Article 3(2) of the OECD Model the terms which are not defined by the treaty should have the meaning which it has according to domestic law of the party applying the treaty unless “context otherwise requires”. As Ward argues the OECD Model generally accepts an asymmetrical interpretation of the bilateral tax treaties and therefore does not generally require from the states to have the same definition. Consequently, the same interpretation of the terms of the treaty according to their domestic laws and Commentaries.⁵⁴ It is true that usually concluding the treaty negotiators have the Commentaries and their observations in front of them⁵⁵. However, it can also be argued that parties also have in front of them the definition given by the domestic laws to the terms. Furthermore, as the treaties are a result

51 Commentaries on the Articles of Model tax convention 2010, commentaries on article 3, paragraph 13

52 Dörr, Oliver, Schmalenbach, Kirsten (eds), *Vienna Convention on the Law of Treaties: a commentary* (Springer Berlin Heidelberg Dordrecht London New York 2012) p.540

53 Ibid

54 David A Ward, “The role of the Commentaries on the OECD Model in the Tax Treaty Interpretation” Bulletin – Tax Treaty Monitor March 2006 p.101

55 Ibid p.100

of consensus and are based on reciprocity⁵⁶ It is difficult to state that the contracting party in this case has expectations according to the principle of good faith from the different party to apply the definition given by the Commentaries. At the same time, Engelen notes that there is no *opinion juris* (the belief by the contracting parties that Commentaries are obligatory) and therefore the OECD Commentaries should not be generally legally binding as “soft law”. However he argues that “*complete and willful disregard of these recommendations constitutes an abuse of right and is not in accordance with the compelling standards of honesty, fairness and reasonableness prevailing in the international community*”⁵⁷ and discusses the principle of legitimate expectations in the public international law, referring to the ICJ case⁵⁸ In this case he demonstrates that generally a non-binding document can be transformed into a legally binding one and can become the part of the context of the treaty in the case of absence of any reaction in a reasonable period of time by the party.⁵⁹ He notes that “*The failure of either party to express, in the course of the negotiations, its disagreement with the interpretation set out in the Commentaries can be regarded as a representation to the effect that it accepts the Commentaries for the purpose of interpreting tax treaty.*”⁶⁰ Therefore the contracting party, according to the principles of good faith and legitimate expectation, is bound with the interpretation set in the Commentaries existing at the time of concluding treaty if :

1. the party does not set any observations on the Commentaries and
2. the party does not indicate in the process of negotiation disagreement with interpretation set out in the Commentaries.⁶¹

In addition, Engelen also argues that in this case the interpretation of the Commentaries can also be considered as the interpretation that parties intended to give to the treaty within the meaning of the Article 31(4) of the Vienna Convention.⁶²

Pijl disagrees with Engelen, stating that OECD Commentaries can only impose a moral obligation on the state. He highlights that according to the Article 5 of the OECD Convention, it is explicitly stated and agreed by the members that recommendations are not binding for the states. In addition, the ICJ case discussed by Engelen can not be compared to the situation in international taxation, as the case of setting border is issue of stability concerning problem of war and peace.⁶³ Therefore PiJl concludes that as member states do not want Commentaries to be binding and therefore do not allow them “*to enter through the front door*” it should not be assumed that states will allow them to “*enter through the back door of the good faith*”⁶⁴ . Furthermore as the OECD members clearly intend not to be bound by the Commentaries, some can argue that there can be no obligation for them to make such declaration in course of the negotiation.⁶⁵The only possibility which PiJl sees for

56 Prof. Dr Klaus Vogel “The Influence of the OECD Commentaries on Treaty Interpretation” Bulletin- Tax Treaty Monitor, December 2000 613

57 Frank Engelen “Some Observations on the Legal Status of the Commentaries on the OECD Model” Bulletin – Tax Treaty Monitor March 2006 p.106

58 International Court of Justice case: Temple of Preah Vihear (Cambodia v. Thailand)

59 Frank Engelen “Some Observations on the Legal Status of the Commentaries on the OECD Model” Bulletin – Tax Treaty Monitor March 2006 p 108-109

60 Ibid 109

61 Frank Engelen “Some Observations on the Legal Status of the Commentaries on the OECD Model” Bulletin – Tax Treaty Monitor March 2006 p 108-109

62 Ibid

63 Hans Pijl, “The OECD Commentary, As a Source of International Law and the Role of the Judiciary” European taxation, May 2006, p. 216-224

64 Ibid p.216

65 Monica Erasmus-Koen and Sjoerd Douma “ Legal Status of the OECD Commentaries – In Search of the Holy Grail of international tax law” Tax Treaty Monitor, Bulletin for international taxation August 2007 p.348

the Commentaries to have more than an auxiliary role for tax treaty interpretation is to consider the Commentaries as a context under Article 31 of the Vienna Convention.⁶⁶

2.3.2 Ordinary meaning

Wattel and Marres argue that the Article 31(1) encourages the application of a textual, teleological and systemic method, focussing mostly on the textual method.⁶⁷ It is also indicated that ordinary meaning of the tax treaty can be considered the meaning which the OECD Commentaries gives to the “term”. In strengthening their position, Wattel and Marres also refer to the official Commentaries of the Vienna Convention which states that the meaning of the terms should not be determined in an abstract way, but according to the context of the treaty as well as object and purpose.⁶⁸ Vogel points out that when the OECD Commentaries remain unchanged for some period of time, it can be considered as “international tax language”.⁶⁹ He points that it is especially true in regards to the terms which were created and then developed with the influence of the OECD Model and its Commentaries.⁷⁰

2.3.3 Context of the Treaty

Wattel and Morres assert that when:

- a) a treaty ratified by the parliament generally follows the OECD Model.
- b) it is clear from the explanatory notes that the OECD's views have to be followed.
- c) when both parties are OECD members or have a chance to set official reservations on Commentaries and fail to do so

In this case, the OECD Commentaries that exists during the conclusion of the treaty should generally be considered a part of the context of the treaty within the meaning of the Vienna Convention. Wattel and Morres consider commentaries as either “*agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty*” or as “*instrument which was made by one or more of the parties in connexion with the conclusion of the treaty and accepted by other parties as an instrument related to the treaty*” within the meaning of Article 31(2) of the Vienna Convention.⁷¹ As it is suggested, when the treaty is based on the OECD Model and it has been presented to the parliaments--indicating that it was based on the model the Commentaries, it can be considered as the context “*equated to parliamentary history, that is to say, the object of consultation between the executive and the parliament within the framework of statutory law-making*”⁷²

At the same time, Vogel suggests to fit commentaries in certain situations under the Article 31(4) of the Vienna Convention, according to which “*A special meaning shall be given to a term if it is established that the parties so intended*”.⁷³

66 Hans Pijl, “The OECD Commentary, As a Source of International Law and the Role of the Judiciary” European taxation, May 2006, p. 216-224

67 Petter J. Wattel and Otto Morres “The legal Status of the OECD commentary and static or Ambulatory interpretation of Tax Treaties” European taxation, July/August 2003, p.225

68 Ibid 226

69 Prof. Dr Klaus Vogel “The Influence of the OECD Commentaries on Treaty Interpretation” Bulletin- Tax Treaty Monitor, December 2000 p.617

70 Klaus Vogel on Double Taxation Conventions, Third Edition, A Commentary to the OECD, UN and U.S. Model Conventions for the Avoidance of Double Taxation of Income and Capital, With Particular Reference to German Treaty Practice, Kluwer law international, 1997 p.37

71 Petter J. Wattel and Otto Morres “The legal Status of the OECD commentary and static or Ambulatory interpretation of Tax Treaties” European taxation, July/August 2003p. 227

72 Ibid p. 234

73 Prof. Dr Klaus Vogel “The Influence of the OECD Commentaries on Treaty Interpretation” Bulletin- Tax Treaty

2.3.4 Object and Purpose

The Article 31 of the Vienna Convention requires tax treaty interpretation according to the object and purpose of the treaty. Even in 1923 the League of Nations noted that double taxation “*was in effect protective tariff on the importation of capital into the source state*”⁷⁴. The OECD Commentaries also highlights the harmful effects which double taxation can have on economic relations between the states and that the elimination of this effects is the main reason for concluding double tax treaties.⁷⁵ Apart from the elimination of double taxation, which is the principal aim of double tax conventions as mentioned in OECD Commentaries, prevention of tax avoidance and evasion are also goals of double tax treaties.⁷⁶ It is also submitted that reasonable understanding of the object and purpose of the treaty is vital in order to apply general rule of interpretation on particular types of treaties.⁷⁷ The courts interpreting tax treaties should try to find the interpretation which will ensure achieving the above mentioned goals. The OECD Commentaries can be seen as the source where this interpretation can be found.

2.3.5 Supplementary Means of Interpretation

According to the Article 32 of the Vienna Convention, supplementary means such as preparatory work of the treaty and circumstances of concluding treaty can be used for interpretative purposes when the interpretation given by the Article 31 “*leaves the meaning ambiguous or obscure or leads to a result which is manifestly absurd or unreasonable*”. While it is believed that the Commentaries can at least be considered as “supplementary means of interpretation”⁷⁸, some scholars admit that it is illogical to put so much work in the Commentaries if countries want them to be only a supplementary means of interpretation.⁷⁹

The difference which can be seen between using Articles 31 and 32 with regards to Commentaries is that if the Commentaries is considered as an “ordinary meaning”, its interpretation must be used in all cases. In contrast, in the case of “supplementary mean of interpretation” the Commentaries should be used if domestic law or tax treaty definition (ordinary meaning of tax treaty term) is obscure and ambiguous.⁸⁰

2.3.6 Summary

In general, ordinary meaning of the term, which is not defined in the treaty, is the meaning which the treaty has according to the domestic law of the contracting states. There can be several

Monitor, December 2000 p.614

74 Christiana HJI Panayi “Double Taxation, Tax Treaties, Treaty-Shopping and the European Community” EUCOTAX Series on European Taxation, 2007 Kluwer Law International p.15

75 Introduction on the OECD Model Tax Convention on Income and Capital 2010 paragraph 1-3

76 OECD Model Tax Convention on Income and Capital 2010 commentary to article 1, paragraph 7

77 Dörr, Oliver, Schmalenbach, Kirsten (eds), *Vienna Convention on the Law of Treaties: a commentary* (Springer Berlin Heidelberg Dordrecht London New York 2012) p.536

78 Petter J.Wattel and Otto Morres “The legal Status of the OECD commentary and static or Ambulatory interpretation of Tax Treaties” European taxation, July/August 2003 p. 228

79 Monica Erasmus-Koen and Sjoerd Douma “ Legal Status of the OECD Commentaries – In Search of the Holy Grail of international tax law” Tax Treaty Monitor, Bulletin for international taxation August 2007 p.348

80 Dörr, Oliver, Schmalenbach, Kirsten (eds), *Vienna Convention on the Law of Treaties: a commentary* (Springer Berlin Heidelberg Dordrecht London New York 2012) p.582

situations when the use of OECD Commentaries is necessary:

1. when there is no definition of the term in the treaty and domestic law definition of the term is the same as the definition of the OECD Model
2. when there is same definition of the term according to the tax treaty and OECD Model.⁸¹
3. when a tax treaty requires a uniform interpretation.⁸²
4. when according to the Article 3(2) of the OECD Model, “context requires otherwise”⁸³

It is fairly argued that the OECD Commentaries can shed a considerable light for the interpretation in this situation. In the first three scenarios it can be argued that Article 31 requires to give internationally accepted (ordinary) meaning to the undefined term, taking into account context and purpose of the treaty. At the same time it is also fairly argued that context of the treaty can not independently suffice to determine the meaning of the treaty, as factors such as good faith, ordinary meaning and object and purpose can lead to different interpretation.⁸⁴ Furthermore the non-binding nature of Commentaries and observations should also be taken into the account.

It can be concluded that if the Commentaries is the context of the treaty, it should also mean that in certain exceptional cases when the context is sufficiently strong the word “requires” in the Article 3(2), make the Commentaries legally binding.

2.4 Vienna Convention - Treaty between non-OECD States without Official Position and OECD States

When discussing the legal status of Commentaries under the Vienna Convention, the scholars usually focus on the status of the Commentaries between OECD countries, or OECD and non-OECD countries with official position. Watel and Mores, while mentioning that the Commentaries can play a role in tax treaty interpretation process for tax treaties between OECD and non-OECD states without official position, note that the role can not be decisive.⁸⁵

The following chapter will figure out the role that Commentaries plays in the tax treaty interpretation. The status of the Commentaries under the Vienna Convention will be discussed with the connection of the UK-mauritius case.⁸⁶

2.4.1 UK- Mauritius Case⁸⁷

The case was mainly concerned with the interpretation of the tie-breaker rule according the Article 4(3) of the treaty, in particular interpretation of the term “place of effective management” according to the UK-Mauritius double tax treaty. The thesis will discuss the reasoning of the court in regards to principles of interpretation of the tax treaties and role of the Commentaries in such interpretation.

81 HMRS vs. Smallwood and Another {2010} EWCA CIV 778 paragraph 98

82 Klaus Vogel on Double Taxation Conventions, Third Edition, A Commentary to the OECD, UN and U.S. Model Conventions for the Avoidance of Double Taxation of Income and Capital, With Particular Reference to German Treaty Practice, Kluwer law international, 1997 p.43

83 Maarten J.Ellis “The Influence of the OECD Commentaries on Treaty Interpretation – Response to Prof. Dr Klaus Vogel” Bulletin- Tax Treaty Monitor, december 2000

84 Ibid p.348

85 Petter J.Wattel and Otto Morres “The legal Status of the OECD commentary and static or Ambulatory interpretation of Tax Treaties” European taxation, July/August 2003 p. 226

86 HMRS vs. Smallwood and Another {2010} EWCA CIV 778

87 HMRS vs. Smallwood and Another {2010} EWCA CIV 778

The Court's Decision

The court started its reasoning providing rules of interpretation of tax treaties set by the UK case law. The court noted that in tax treaty interpretation the court should take into consideration the following circumstances:

1. The court should start with literal approach and literal meaning of the term
2. The court should take into consideration that the tax treaty is not drafted by English parliament, so the language of the treaty can not always be interpreted according “*technical rules of English law or by English legal precedent*” but also general principle of interpretation should be followed.
3. Among general principles the court considers article 31(1) of the Vienna Convention, to find out context of the treaty and intention of the parties
4. If the meaning is still ambiguous or leads to absurd result, court suggest to use article 32 of the Vienna Convention.
5. As the court notes, the subsequent Commentaries can be used only as an argument of persuasive value
6. Furthermore, international case law and writings of jurists can also be used discretionary but not mandatory, taking into account the relevance and weight of such sources.⁸⁸

The court noted about the relevance of using the Commentaries in this situation:

*“ Our view is that the negotiators on both sides would be expected to have commentary in front of them and can be intended that the meaning in the commentary should be applied. In interpreting Treaties when it contains identical wording ”*⁸⁹

After this conclusion, the court highlighted that Mauritius, unlike to the United Kingdom, is neither an OECD member nor a non-OECD country which does set official position on the Commentaries, but the court still considered that above mentioned statement “ *is as much true of the United Kingdom as it is of Mauritius* ”⁹⁰ The court pointed out that “ *If the Commentaries contains a clear explanation of the meaning the term it seems clear that the party of the treaty intended such explanation* ” The court considered the Commentaries either as a means of interpretation under article 31(4) stating that party intending the meaning as “special meaning”, or see it as a means of interpretation under other non-codified principles. In order to support its conclusion, the court cited the Commentaries of the Vienna Convention, which stated that Articles 31 and 32 of the Convention codified only parts of the general principle of treaty interpretation.⁹¹

Comments

The court sees Commentaries as a means of interpretation according to the Vienna Convention, which thus concludes that the Commentaries is binding under public international law when both the Model and the treaty contain identical wording. The author of the thesis believes that the OECD Commentaries in this case can not generally be considered as “context”. Wattel and Morres fairly argues that for the Commentaries to become context of the treaty, it is vital that the party is able to indicate its position on the Commentaries.⁹² The court points out that the party has the expectation that the OECD Commentaries should be used when it comes to the same terms used in Model and

88 HMRS vs. Smallwood and Another {2010} EWCA CIV 778 paragraph 94

89 Ibid paragraph 98

90 HMRS vs. Smallwood and Another {2010} EWCA CIV 778 paragraph 98

91 Ibid

92 Petter J.Wattel and Otto Morres “The legal Status of the OECD commentary and static or Ambulatory interpretation of Tax Treaties” European taxation, July/August 2003p. 227

the treaty. However, it is still not clear why the party has such an expectation from the state which does not set any position on Commentaries. Therefore, the Commentaries should not generally be considered also as a “special meaning” appealing on intention of parties, unless from the preparatory works and documentation it is clear that OECD Commentaries should be followed. It can also be argued that Mauritius could have some expectations from the UK, in particular that the UK would have explicitly indicated in the treaty if it thinks that Commentaries should be legally binding. This argument can be supported by the existence of some other treaties between the OECD and non-OECD economies without official position.⁹³

2.5 Vienna Convention and taxpayer

While the Vienna Convention makes an obligation on the state by public international law, it can be argued whether or not a taxpayer can be legally bound by the Convention. The double tax treaty is unique with these regards as disputes concerning interpretation of the treaty are between taxpayer and state and not between contracting states.⁹⁴ It is argued that “*the actual travaux préparatoires of particular bilateral tax treaties are not available to taxpayers or the public. It therefore cannot be known what positions the negotiating parties actually took in the course of their negotiations regarding the interpretation of a particular tax treaty. Unpublished travaux préparatoires are not admissible in the treaty interpretation process*”⁹⁵

2.6 Summary – Commentaries under the Vienna Convention

This thesis supports the view that the OECD Commentaries should not generally be considered legally binding under the Vienna Convention as states explicitly do not want Commentaries to be legally binding. However, the Commentaries can be the instrument which can help the courts find the most suitable interpretation taking into account and as it suggested combine all factors such as context, ordinary meaning, good faith, object and purpose of the treaty.⁹⁶

The commentaries as it suggested can always be considered as a supplementary means of interpretation⁹⁷ which means that the Commentaries may be used by the domestic courts when the ordinary meaning of the treaty is ambiguous or leads to unreasonable and absurd result.

In regards to the Article 3(2), it can be concluded that in connection to Articles 31 and 32 when it is sufficiently clear that the OECD Commentaries is context of the treaty, the OECD Commentaries can override the domestic law definition. However, it should be noted that it is not the case in every situation but as Jones argues only when the context is sufficiently strong⁹⁸. It can be the case when it is clear that the intention of the parties concluding the treaty was to use the meaning of the Commentaries. For example, as mentioned in OECD Commentaries it can be the case when the

93 See for example Georgia-Austria and Georgia-Denmark double tax treaties

94 Monica Erasmus-Koen and Sjoerd Douma “Legal Status of the OECD Commentaries – In Search of the Holy Grail of international tax law” Tax Treaty Monitor, Bulletin for international taxation August 2007 p. 346

95 Ibid

96 Dörr, Oliver, Schmalenbach, Kirsten (eds), *Vienna Convention on the Law of Treaties: a commentary* (Springer Berlin Heidelberg Dordrecht London New York 2012) p.536

97 Petter J. Wattel and Otto Morres “The legal Status of the OECD commentary and static or Ambulatory interpretation of Tax Treaties” European taxation, July/August 2003 p. 228

98 John F. Avery Jones “The interpretation of tax treaties with particular reference to article 3(2) of the OECD Model” Reprinted from The British Tax Review 1984 #1 and 2, p108

contracting party tries to abuse the right and amend the domestic law unilaterally.

2.7 Some Observations about Georgia-Denmark and Georgia-Austria Tax Treaty

As it was mentioned above, some tax treaties contain special provisions in the tax treaty indicating a legal force of the Commentaries. For example, Georgia - Denmark and Georgia - Austria double tax treaty in the protocol of the treaties State :

“It is understood that provisions of the agreement that are drafted according to the corresponding provisions of the OECD Model Tax Convention on income and capital shall generally have the same meaning as expressed in the OECD commentaries thereon. This understanding shall not apply with respect to:

- a) any reservation or observation to the OECD Model or its commentary by either contracting states*
- b) any contrary interpretation agreed by the competent authority*

The OECD commentary as it may be revised from time to time constitutes a mean of interpretation in the sense of the Vienna Convention of 23 May 1969 on the Law of Treaties”⁹⁹

This kind of treaties should be discussed separately . While the statement brings some clarity for the interpretation of these treaties, it also creates confusions. The Article 3(2) of the treaty refers to internal law of the countries to define undefined terms. At the same time, the protocol which is part of the treaty considers the Commentaries as a means of interpretation and therefore as legally binding instrument under the Vienna Convention, unless there is an explicit contrary agreement between the states or parties set their observations on commentaries. (The last part of the provision today can only be relevant to Denmark and Austria as Georgia does not set any official position on commentaries). Therefore, it can be concluded that the ordinary meaning of the undefined terms of the treaties is meaning of the existing Commentaries at the moment of applying the treaty. The main confusion which this interpretation brings is for the purpose of interpretation other tax treaties. The general statement that the Commentaries is a means of interpretation under the Vienna Convention can be very controversial.

1.Can a taxpayer argue that this state generally recognizes the OECD Commentaries to be legally binding according to the Vienna Convention?

Or

2 can the non-member state argue that the Commentaries is never binding for non-member states unless there is an explicit provision about it in the tax treaty?

These are the questions that logically come to mind when non-member states make such kind of statement in regards to a certain treaty.

Ward, who does not support the idea of giving any legally binding effect to the Commentaries under the Vienna Convention, states in regards to some Austrian treaties—like the ones Austria and Denmark have with Georgia that in those situations opinio juris i.e - belief by the state that the commentaries are binding is presented.¹⁰⁰ As it is also fairly argued, by including the protocol into

99 See for example: Article 8 of the protocol of Georgia-Austria Double Tax Treaty , Conclusion Date 11 April, 2005 http://english.bmf.gv.at/Tax/DoubleTaxationAgreements/TheAustrianTaxTreat_271/GeorgienE.pdf and Article 1 of the protocol of Georgia- Denmark Double Tax Treaty, Conclusion Date 10 October, 2007 <https://www.retsinformation.dk/Forms/R0710.aspx?id=122141>

100David A Ward, “The role of the Commentaries on the OECD Model in the Tax Treaty Interpretation” Bulletin – Tax Treaty Monitor March 2006 p.100 footnote 19

the treaty parties are automatically legally bound by the interpretation given by the Commentaries to the extent that treaty provisions copy the provisions of the OECD Model.¹⁰¹ Avery Jones notes that this kind of protocol in the treaty is the “interesting way of increasing the status of the Commentaries”¹⁰²

3. Ambulatory or Static Interpretation

While as it was mentioned the OECD accepts ambulatory interpretation of the Commentaries, the use of the later Commentaries for tax treaty interpretation is under a question. The main reason for it is that the renegotiations of existing tax treaties is difficult and time-consuming process, some argue that the renegotiations are even impossible because of large amount of the treaties.¹⁰³ The ambulatory interpretation also leads to some problems, the mains from which are the degree of legitimacy of later Commentaries, legal certainty, its relation with Article 31 of the Vienna Convention and the rights of taxpayers.¹⁰⁴

Before going into details of the above mentioned problems, it should be highlighted that the later Commentaries can:

1. fill the gap in the previous Commentaries
2. amplify the existing Commentaries
3. express the states previous practice in this field
4. contradict the existing Commentaries¹⁰⁵

3.1 The Problem of Using Later Commentaries

It is argued that the principle *pacta sunt servanda* requires static interpretation of the tax treaties, based on the intention of the parties at the moment of concluding treaties.¹⁰⁶ This principle is closely related to the problem of legitimacy of using the subsequent Commentaries. As one can argue that Commentaries can be seen as “context” of the treaty or “special meaning” which parties intended to give the treaties, this can less likely be argued in the case of the later Commentaries. Even if we consider the later Commentaries to be a part of the context according to Article 31(3) of the treaty as “subsequent agreement” between the parties, there can still remain constitutional problems for the countries.¹⁰⁷ Treaties are usually ratified by the parliament, while the position on the Commentaries is set by government representatives who do not have the same degree of legitimacy. Furthermore, the problem becomes more complicated with regards to non-OECD countries that do not set any official position. It is also noted that a taxpayer should have some certainty about his/her possible tax obligation. For example, a taxpayer in tax year N should not be treated differently than in tax year N+1 only because of changes in the Commentaries, unless these changes have the same democratic legitimacy as changes in tax treaties.¹⁰⁸ Some can also argue that as the

101 Monica Erasmus-Koen and Sjoerd Douma “Legal Status of the OECD Commentaries – In Search of the Holy Grail of international tax law” Tax Treaty Monitor, Bulletin for international taxation August 2007 p.341

102 John Avery Jones, “Are tax treaties necessary” 53 Tax L.Rev 1 1999-2000 p20

103 John Avery Jones, “Are tax treaties necessary” 53 Tax L.Rev 1 1999-2000 p20

104 Petter J. Wattel and Otto Morres “The legal Status of the OECD commentary and static or Ambulatory interpretation of Tax Treaties” European taxation, July/August 2003

105 David A Ward, “The role of the Commentaries on the OECD Model in the Tax Treaty Interpretation” Bulletin – Tax Treaty Monitor March 2006 p.101

106 Petter J. Wattel and Otto Morres “The legal Status of the OECD commentary and static or Ambulatory interpretation of Tax Treaties” European taxation, July/August 2003 p.222

107 Dr. John F. Avery Jones “The Effects of Changes in the OECD Commentaries after a Treaty is Concluded” Bulletin – Tax treaty Monitor, March 2002 p.103

108 Petter J. Wattel and Otto Morres “The legal Status of the OECD commentary and static or Ambulatory interpretation of Tax Treaties” European taxation, July/August 2003 p.222-223

view of the Commentaries usually represents the view of tax authorities, the courts should interpret treaties in an objective way and not rely only on an interpretation given by the Commentaries.¹⁰⁹

Fijian Case

The case¹¹⁰ concerned the issue of whether or not the UK company had a permanent establishment in Fiji. The Double Tax Treaty between the UK and Fiji was based on the OECD Model of 1963. After this time there were two revisions of the OECD Model and Commentaries in 1977 and in 1992. Both, the High Court as well as the Appeal Court of Fiji used the 1963 version of the Commentaries for tax treaty interpretation. The Appeal Court agreed with the High Court stating:

“In coming to that conclusion his Lordship adopted the approach taken in the 1963 commentary, noting that it had received the approval of the majority of commentators who had considered the provision. Reference to travaux preparatoires is accepted in international law as one of the tools which can in certain circumstances, be used to interpret treaties between countries.... Recourse to the supplementary means of interpretation, including reference to travaux preparatoires are permitted by Article 32 only to confirm the resulting from applying Article 31 either produces as meaning which is ambiguous or obscure or leads to a manifestly absurd or unreasonable result.”¹¹¹

It can be concluded from this reasoning that the courts of Fiji consider the later Commentaries as a supplementary means of interpretation, which can be used only when according to Article 31 of the Vienna Convention the ordinary meaning of a treaty is ambiguous.

The appeal court of Fiji made an interesting position on the status of the Commentaries between OECD and non-OECD states existing at the time of concluding the treaty, stating that:

“ It was proper for him to refer to the commentary because even though the convention must be regarded as incorporated into the domestic law of Fiji by virtue of the statutory basis by which the Minister was authorised to enter into it (Income Tax Act Section 106) The international law obligations of comity require that, so far it is possible, its provisions be construed in the manner in which the other party to it might reasonable expect, in this instance regard to the fact that it was based on OECD draft Model”¹¹²

With this regards, it seems that Fiji sees the Commentaries existing in the time concluding a treaty as binding according to the rules of interpretation of the Vienna Convention. The courts do not use the term “good faith” but mention “reasonable expect” from the other party .

3.2 In Favour of Ambulatory Interpretation

While there are many drawbacks in regards to the application of the Commentaries in ambulatory way, in some cases the courts use the ambulatory interpretation. The importance of the later Commentaries, as Avery Jones argues, is undoubtable. He highlights that the real issue is not whether or not the later Commentaries should be taken into account but, “ *how much weight should*

109Dr.John F. Avery Jones “The Effects of Changes in the OECD Commentaries after a Treaty is Concluded” Bulletin – Tax treaty Monitor, March 2002 p.103

110Fiji, Civil appeal ABU 0022 of 1994

111Fiji, Civil appeal ABU 0022 of 1994

112 Ibid

be given to them in any particular situation”¹¹³

If courts generally follow writings of authors for their argumentations, which can be written after conclusion of the treaty, it is believed that there is no relevant point why the later Commentaries should be disregarded.¹¹⁴ It is also argued that evaluating the later Commentaries should be similar to evaluation of the weight of the opinion of respected tax experts.¹¹⁵ One of the the main arguments in favour of the later Commentaries is the necessity to comply with ongoing changes in the areas of business and technology.¹¹⁶

As it was noted by the UK appeal court in Smallwood case¹¹⁷

*“The relevance of commentaries adopted later than treaty is more problematic because the parties can not have intended the new commentary to apply at the time of making the treaty. However to ignore them means that one would be shutting one's eyes to advances in international tax thinking, such as how to apply the treaty to payments for software that had not be considered when treaty was made. The safer option is to read the later commentaries and decide in the light of it content what weight should be given to it”*¹¹⁸

The changes in the approach of interpretation of the international treaty is not new for the international law. Watel and Morres point out on the European Court of Human Rights, which states that the convention is a living instrument and should be interpreted in a way which can ensure effective protection of human rights and *“failure by the court to maintain a dynamic and evolutionary approach would risk rendering it a bar to reform or improvements”*¹¹⁹ Some authors also contend that in particular cases the reliance on a static interpretation can result to infringement of international obligations, such as the EU law or the WTO law.¹²⁰

The scholars discussing a status of the later Commentaries often highlight the character of changes. Ward asserts that when changes in the Commentaries only clarify the existing model, giving a new example can be seen to have a similar weight as opinions of tax commentators.¹²¹ It can also be a useful tool to determine the “ordinary meaning” of the treaty, especially when it comes to technical terms. At the same time Vogel argues that the later Commentaries can not retroactively constitute ordinary or special meaning of the treaty according to Article 31 of the Vienna Convention¹²². Further it is also mentioned that depending on internal administrative law taxpayer, in certain countries a taxpayer can rely on the new Commentaries according to the principle of legitimate expectation unless the countries do not set any reservations on the Commentaries.¹²³ In certain cases

113Dr.John F. Avery Jones “The Effects of Changes in the OECD Commentaries after a Treaty is Concluded” Bulletin – Tax treaty Monitor, March 2002 p.103

114 Ibid

115Prof. Dr Klaus Vogel “The Influence of the OECD Commentaries on Treaty Interpretation” Bulletin- Tax Treaty Monitor, December 2000

116Dr.John F. Avery Jones “The Effects of Changes in the OECD Commentaries after a Treaty is Concluded” Bulletin – Tax treaty Monitor, March 2002 p.103

117HMRS vs. Smallwood and Another {2010} EWCA CIV 778

118Ibid paragraph 99

119 Petter J.Wattel and Otto Morres “The legal Status of the OECD commentary and static or Ambulatory interpretation of Tax Treaties” European taxation, July/August 2003 p. 223

120Ibid

121David A Ward, “The role of the Commentaries on the OECD Model in the Tax Treaty Interpretation” Bulletin – Tax Treaty Monitor March 2006 p.101

122Prof. Dr Klaus Vogel “The Influence of the OECD Commentaries on Treaty Interpretation” Bulletin- Tax Treaty Monitor, December 2000

123 Petter J.Wattel and Otto Morres “The legal Status of the OECD commentary and static or Ambulatory interpretation of Tax Treaties” European taxation, July/August 2003 p. 234

the Commentaries can be considered as a supplementary means of interpretation under Article 32 of the Vienna Convention. The substantive changes, like changes in the Model itself or the Commentaries which explicitly contradict to the previous model and the Commentaries is argued to have no legitimate role for the interpretation¹²⁴. An interesting point in regards to retroactive application of the Commentaries was mentioned by Wattel and Morres, admitting Danish tax authorities approach. The authorities refuse the retroactive application of the Commentaries in cases when it leads to a disadvantageous result for a taxpayer.¹²⁵

3.3 Summary

The only possibility to fit the later Commentaries under context according to Article 31 of the Vienna Convention is to consider them as a “subsequent agreement” according to the Article 31(3), which is less likely possible because lack of legitimacy of the changes in the Commentaries, as it never passes the parliament. Therefore, the later Commentaries can only be seen as

1 A supplementary means of interpretation under Article 32 of the Vienna Convention when a different interpretation is unreasonable and absurd. For example, if static interpretation is outdated or can result in offending international obligations,

or

2. An argument having a high persuasive value, like writings of tax scholars with the limitation discussed in the chapter.

With this regard the same picture can be drawn about the interpretation of the tax treaties between OECD and non-OECD states with official position on the Commentaries and OECD and non-OECD states without such position.

In regards to tax treaties with a special reference on the Commentaries it should be noted that the treaties with the wording “*which may be revised from time to time*” call for an ambulatory interpretation.¹²⁶ In this case, the later Commentaries have a higher degree of legitimacy than later Commentaries in general as parliament ratifying the treaty also agrees to apply ambulatory interpretation of the Commentaries. The problem of using the later Commentaries when it leads to retroactive application of the Commentaries can also be an issue. Danish tax authorities' approach not to apply the Commentaries retroactively when it is disadvantageous for taxpayer can solve the problem. However, it is not the fact that this approach would be used by all countries having special reference to the Commentaries.

4. The Role of the OECD Commentaries – Case Law Analysis

The fact whether or not the OECD Commentaries is binding according to public international law is obviously the issue of high importance. However even if there is no such obligation for the state to follow the Commentaries, it does not mean that this fact “*throws community into the essential darkness*”¹²⁷. The Commentaries can always have a high ranking value and a great weight for the

124 David A Ward, “The role of the Commentaries on the OECD Model in the Tax Treaty Interpretation” Bulletin – Tax Treaty Monitor March 2006 and Petter J. Wattel and Otto Morres “The legal Status of the OECD commentary and static or Ambulatory interpretation of Tax Treaties” European taxation, July/August 2003

125 Petter J. Wattel and Otto Morres “The legal Status of the OECD commentary and static or Ambulatory interpretation of Tax Treaties” European taxation, July/August 2003 p. 234-235

126 See for example Georgia-Austria and Georgia-Denmark double tax treaties

127 Monica Erasmus-Koen and Sjoerd Douma “ Legal Status of the OECD Commentaries – In Search of the Holy Grail of international tax law” Tax Treaty Monitor, Bulletin for international taxation August 2007 p.346

interpretation.¹²⁸ Ward believes that all attempts to fit the Commentaries under the rule of interpretation of the Vienna Convention are in vain, but he still highlights the importance of the Commentaries for interpretative purposes.¹²⁹ Furthermore, Pijl points that it is only courts that are able to move the Commentaries to a definite and concrete international order.¹³⁰ Monica Erasmus-Koen and Sjoerd Douma indicate that in the most cases tax courts refer to the Commentaries without mentioning the Vienna Convention, considering the Commentaries as “*important guidance for interpretation and application*”¹³¹

In the following chapters this thesis will discuss the case law of Russia and India on the role of the Commentaries for a treaty interpretation, and in thus will demonstrate how tax courts consider the role of the Commentaries for a tax treaty interpretation in non-OECD countries in order to assess the role of the Commentaries for tax treaty interpretation between OECD and non-OECD states.

4.1 Russia

The case is the first and the only Russian Supreme Court case in which the court referred to the OECD Commentaries. As argued, while the decision may have some judicial weaknesses, the influence of this case seems to be significant.¹³²

Facts of the Case

The Russian company A received a loan from two other Russian companies B and C. Then, company B assigned its claim to Swiss company D, which then also assigned its claim to Luxembourg company E. There was not any payment between companies A and B and therefore neither between D and E. Between companies A and C the debt was paid later but the penalties and interest for delay were not paid. It was agreed by all parties of the case that companies B and C were related to Cypriot company F, that at the same time indirectly held more than 20 percent in the company A. The Swiss company D also held more than 20 percent in company A. The total amount of debt taken by A was more than three times as much as companies' equity. According to the Russian tax code when the debt of the Russian company to a foreign related company is at least three times more than equity the thin capitalization rules applies. Thus, tax authority demanded application of these rules. The courts of the first two instances dismissed the tax authorities' claim stating that Article 24 of the Russian-Swiss and Russian-Cypriot tax treaties prohibits discrimination of foreign companies in comparison to Russian companies. The court held that as according Russian Tax Code thin capitalization rules are applicable only in regards to foreign companies, the tax treaty provision about non-discrimination should take precedence on the domestic law.¹³³

The Court's Decision

The Supreme Arbitrate Court pointed out that while the Article 24 prohibits the discrimination of

128Prof. Dr Klaus Vogel “The Influence of the OECD Commentaries on Treaty Interpretation” Bulletin- Tax Treaty Monitor, December 2000

129David A Ward, “The role of the Commentaries on the OECD Model in the Tax Treaty Interpretation” Bulletin – Tax Treaty Monitor March 2006, supra note

130Hans Pijl, “The OECD Commentary, As a Source of International Law and the Role of the Judiciary” European taxation, May 2006 p.221

131Monica Erasmus-Koen and Sjoerd Douma “ Legal Status of the OECD Commentaries – In Search of the Holy Grail of international tax law” Tax Treaty Monitor, Bulletin for international taxation August 2007 p. 349

132 <http://www.sameta.ru/alerts/427/>

133Supreme Arbitrate Court of Russian Federation, case No.8654/11

foreign companies and thus ensuring equal treatment of domestic and foreign companies, this article does not exclude the possibility to apply special rules in order to counter tax avoidance. After this reasoning, the court referred to the OECD Commentaries as the “*framework document setting the common principles and standards in order to eliminate double taxation*”¹³⁴. In particular, the court noted that according to the Commentaries on the Article 9(3b) of the OECD Model “*the Article is relevant not only in determining whether the rate of interest provided for in a loan contract is an arm’s length rate, but also whether a prima facie loan can be regarded as a loan or should be regarded as some other kind of payment, in particular a contribution to equity capital;*” Therefore the court found that as the companies were “associated enterprises” Article 9 of the Swiss-Russian and Cypriot-Russian treaties was also applicable and the application of the thin capitalization rules was not against non-discrimination clause and tax treaty.¹³⁵

Comments

Although the supreme court refers to the Commentaries, it is not clear the status that the court is assigning to it. The court does not discuss legal status of the Commentaries in the Russian Legal Order:

1. The court does not trigger the issue whether or not it is relevant that Russia indicated a special position on the Commentaries
2. There is no discussion about the Vienna Convention
3. The court seems to use ambulatory interpretation of the Commentaries without explaining any reasons and legal bases for it.

These issues were also relevant because the case concerned very debatable aspects, in particular using domestic anti-abuse rules in the treaty situations. The case becomes more complicated as Switzerland-Russia treaty was signed in 1995. At the same time, the possibility of using domestic anti-abuse rules in tax treaty situation was created by changes in commentaries in 2003, Switzerland was the only country that clearly set the position contrary to the position of the majority of countries, including Russia. In this position Switzerland stated that it does not consider prevention of tax avoidance to be purpose of tax treaties.¹³⁶ As treaties are usually based in the principle of reciprocity, it is argued that one of the main problems which arose from this situation was whether taxpayers expect countries having a treaty with Switzerland not to apply tax treaties to prevent tax avoidance.¹³⁷ the Russian court attempted to avoid discussing problematic issues of the role of Commentaries such as, its relation with the Vienna Convention, problem of ambulatory application of the treaty, and relevance of the countries' official observations on the Commentaries. It can be concluded that the Russian court perceives the existing Commentaries, as international practice, “framework document” for the interpretation of the treaty without going further in details.

4.2 India

India is the country that has substantial tax treaty case law.¹³⁸ While the reference to foreign tax court decisions and the OECD Commentaries are subject of criticism and there is no clear

134Ibid, Unofficial translation

135Ibid

136 Brian J. Arnold “Tax Treaties and Tax Avoidance: The 2003 Revisions to the Commentary to the OECD Model” Bulletin-Tax Treaty Monitor, june 2004

137 Ibid p.248

138 See for example IBFD tax treaty case law database

consistency about the role of the Commentaries by the courts¹³⁹, some cases can be useful to determine the general picture. While discussing the India tax treaty case law, it should be noted that it was only in 2010 when India set its official position on the Commentaries.¹⁴⁰

4.2.1 India before Setting Official Position

The Ericsson case¹⁴¹ concerned several issues. One of the issues, which has a particular interest for this thesis was whether or not the payment for composite supply of hardware and software constituted royalty and therefore whether the payment was taxable according to Article 13 of the India-Sweden double tax treaty.

Facts of the cases

Ericsson was a company resident in Sweden. It entered to the agreement to several Indian customers to make a supply of network equipments. The equipments contained both hardwares and softwares. The installation was made by the Indian affiliate of Ericsson according to the terms of the contract between them and Indian customers. There was also a general agreement between three parties involved in order to coordinate the supply and installation process.¹⁴²

The tax authority argued that the payment constituted the royalty for several reasons:

1. The supply should be divided into two supplies: supply of hardware and supply of software
2. The payment was received for the use of software, so it should have been taxed as royalty
3. The Indian authorities noted that when it comes to interpretation of tax treaty, the OECD Commentaries should not be relied upon¹⁴³

The taxpayer argued that the payment should not be taxed as royalty as

1. The main agreement was about the supply of hardware. The supply of software was just an inseparable part of the main supply. Therefore, there was no independent payment for copyright of software which could constitute royalty.
2. Even if this statement was wrong, the taxpayer argued that according to the tax treaty the payment was not made for “use” or “right of use” of copyright as the software was used only to exploit the hardware. The taxpayer pointed on the OECD Commentaries as on the document of high persuasive value and noted that there was no commercial use of copyright and the payment was for just “copyright article”.¹⁴⁴

Court Decision

The court held that the payment can be considered as royalty only if it constitutes payment for copyright right and not for copyright article. The court noted that “*we may also usefully referred to*

139Ankit Virenda Sudha Shash supra note

140the OECD Model Tax Convention on Income and Capital 2010

141Income Tax Appellate Tribunal, decision of June 22, 2005 case No. 815, 1798, 1963, 1964, 2455, 2510, 2511 and 2516 (DELHI) of 2001

142Income Tax Appellate Tribunal, decision of June 22, 2005 case No. 815, 1798, 1963, 1964, 2455, 2510, 2511 and 2516 (DELHI) of 2001

143 Ibid

144Ibid

*the commentary on the OECD Model Convention (28-1-2003) which is of persuasive value which throughs considerable light on the character of the transaction and to the treatment should be given to the payment for tax purposes*¹⁴⁵ In order to distinguish copyright article from copyright right, the court based its reasoning on the OECD Commentaries and on the amendments in the US regulations, admitting that while they do not have a binding nature they have a high persuasive value. As a result the court found that the payment was made for copyright article and therefore could not constitute royalty.¹⁴⁶ The court also relied on the OECD Commentaries, noting that the payment was done for the hardware and it was not acceptable to split the payment as there was no initial payment for copyright of software.

Shash also cites an interesting approach shown by the Kolkata Court which to strengthen its position about the interpretation of the double tax treaty stated that *“interpretation is clearly in harmony with the OECD and UN Model Conventions’ official commentaries, these model conventions and commentaries thereon constitute international tax language and the meanings assigned by such literature to various technical terms should be given due weightage. In our considered view, the views expressed by these bodies, which have made immense contribution towards development of standardisation of tax treaties between various countries, constitute ‘contemporanea expositio’ inasmuch as the meanings indicated by various expressions in tax treaties can be inferred as the meanings normally understood in, to use the words employed by Lord Radcliffe, ‘international tax language’ developed by bodies like OECD and UN.”*¹⁴⁷

4.2.2 India After setting Official Position

Two controversial Judgments

In general there is no consistent and clear view about legal characterization of the observation and impact which observation of contracting state may have on treaty interpretation.¹⁴⁸ Therefore it becomes more interesting to see how India's observation on the Commentaries influences the Indian tax treaty case law. While it is argued that the setting of official position on the Commentaries may shed some light and have influences on the practice of referencing the OECD Commentaries in India, it is also noted that in recent cases some controversies can be seen with this regard.¹⁴⁹

Asia Satellite case¹⁵⁰:

Facts of the cases

The taxpayer did not own any asset and was not presented in India. Taxpayer was a company incorporated in Hong-Kong and performed all operations there. The taxpayer made an agreement with TV channels that provided its transporter capacities. The TV channels from the facilities located outside India were uplinking signals to satellites then used satellite footprint which

145Ibid Paragraph 165

146 Ibid

147 Case Graphite India LTD vs DCIT (86 ITD 384) Cited from: Ankit Virenda Sudha Shash “The Legitimacy of Reference to OECD Commentary for interpretation of Income Tax Act and DTAAs” february 2012 see on: <http://www.bcasonline.org/articles/artin.asp?1035>

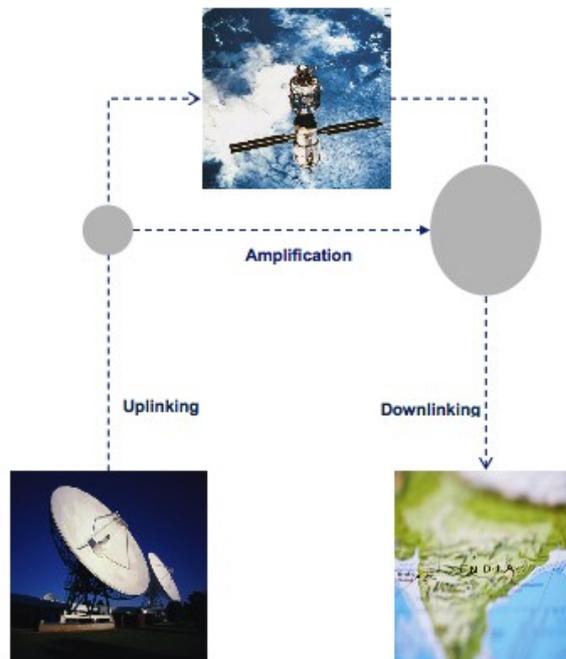
148See for example: Guglielmo Maisto “The Observations on the OECD Commentaries in the Interpretation of tax treaties” Bulletin-Tax Treaty Monitor, January 2005

149 Ankit Virenda Sudha Shash “The Legitimacy of Reference to OECD Commentary for interpretation of Income Tax Act and DTAAs” february 2012 see on: <http://www.bcasonline.org/articles/artin.asp?1035>

150High court of Delhi at New Delhi ITA No.131 of 2003 with ITA No.134 of 2003, date of decision 31 January, 201

included India. The signal from transponder without changes was downlinked to cable operators.¹⁵¹ The main issue was whether or not the payment according to the “transponder leasing” agreement constituted royalty by following Indian domestic law.

Pictorial description of the process involved : ¹⁵²



The tax authority argued that the taxpayer had a business connection with India as it was its obligation to make programs available in India and the sources of income received by the taxpayer were the TV viewers in India. They also argued the fact that the satellite was fully controlled from Hong-Kong was irrelevant as the the definition of the royalty according to domestic law of India in the wording of “use” does not imply only “right to use” of the equipment and process.¹⁵³

Decision

High Court its reasoning that the payment for “transponder leasing” did not constitute royalty, relied heavily on the OECD Commentaries. The court noted that when it comes to technical terms which is the same in the various tax treaties and in the Indian domestic law, the meaning of the OECD Commentaries as internationally accepted meaning should always be a reliable source for interpretation.¹⁵⁴

Comment

While the case did not concern the tax treaty interpretation issue and concerned the interpretation of the domestic law, the decision can be of high importance for interpretation of double tax treaties.

¹⁵¹Ibid

¹⁵²Description from: KPMG in India Flash news february 2, 2011

¹⁵³High court of Delhi at New Delhi ITA No.131 of 2003 with ITA No.134 of 2003, date of decision 31 January, 2011

¹⁵⁴Ibid paragraph 77

The court mentioned that in certain cases the Commentaries can *always* be “reliable source for interpretation”. It can be concluded that in these cases the court considered that the Commentaries is something more than just an argument of persuasive value.

The court relied on the OECD Commentaries that stated:

“Satellite operators and their customers (including broadcasting and telecommunication enterprises) frequently enter into “transponder leasing” agreements under which the satellite operator allows the customer to utilise the capacity of a satellite transponder to transmit over large geographical areas. Payments made by customers under typical “transponder leasing” agreements are made for the use of the transponder transmitting capacity and will not constitute royalties under the definition of paragraph 2: these payments are not made in consideration for the use of, or right to use, property, or for information, that is referred to in the definition (they cannot be viewed, for instance, as payments for information or for the use of, or right to use, a secret process since the satellite technology is not transferred to the customer) “155

The point which was not discussed was that India had official position, stating that India disagreed with the above mentioned view expressed by the Commentaries. There is some important issues which should be taken into consideration:

1. The court used the latest version of the Commentaries. It should be noted that interpretation concerned technical terms and there were no substantial changes in the Commentaries but only some new examples were added by the update of the Commentaries on 22 July of 2010
2. In this update India made a clear observation that the country disagrees with the view expressed in the Commentaries.
3. At the time of payment the issue was not regulated by the Commentaries. The issue was unregulated even when the lower court discussed the case and concluded that the payment constituted royalty.

As it is argued the later Commentaries should be discussed similar to writings of tax commentators and be evaluated due to weight. With this regard the reliance on the above mentioned version of the OECD Commentaries for interpretation of technical terms generally seems logical. It seems that the Indian court in this Judgment does not consider the official position of India binding for tax courts and taxpayers and in thus it only demonstrates the view of the Indian government.

Microsoft case¹⁵⁶

The issue discussed in this case was whether or not the payment for supply of copyrighted software constituted royalty according to India-USA double tax treaty. As it is argued the case was important and is expected to have significant consequences as the court's findings were contrary to some earlier decisions.¹⁵⁷

Facts

Microsoft Corporation gave the license to its subsidiary Gracemac to manufacture and distribute computer softwares. Gracemac gave the license to Microsoft operation LTD Singapore company to manufacture and distribute the products in Singapore. The LTD paid royalty to Gracemac from the selling price. In turn the Singaporean company was appointed as non-exclusive distributor with

155 OECD Model Tax Convention on Income and Capital 2010 commentary to article 1, paragraph 12

156 M/s Microsoft Corporation vs Asst Director of Income-tax, M/s Gracemac Corporation vs Asst Director of Income-tax and Microsoft Regional Sales Corporation vs Assistant Director of Income-tax, International Tax Division, Circle 21(1) 2010-TII-141-ITAT-DEL-INTL (Judgment date – 26 October 2010)

157 KPMG in India Flash news 29 October 2010

the function to sell reproduced and manufactured software products in different countries, including India. The Ltd sell this products to Indian re-sellers/distributors which at the end of the day were selling the products to final Indian customers.¹⁵⁸

Taxpayer argued that payment received from Indian re-sellers is for “copyright article” and not for copyright as the final users do not have any right of copyright of software. Taxpayer argued that in order to constitute payment for copyright and therefore royalty, the software should be reproduced for commercial purposes and only installation and storage on the hard disc of programs are not enough to constitute copyright. The argumentation of taxpayer was relied on OECD Commentaries and the decision of Special Bench in one of the cases.¹⁵⁹

The tax authorities argued that the OECD Commentaries are unacceptable aid for interpretation and decision should be made according Indian domestic law and double tax treaty. They noticed that Indian domestic law as well as double tax treaty do not use term “copyright article”. They also pointed on the Indian government's publication “hand book of copyright law” to define copyright and noticed that copyright meant making one or more copies and there was no requirement of mass copies or copies for commercial purposes. In regards to decision of Special Bench the tax authorities noted that the case was distinguishable in facts.¹⁶⁰

Decision

With regard to using OECD Commentaries as well as US regulations the court highlighted that the definition of royalty under double tax treaty and Indian domestic law was not ambiguous. Furthermore in double tax treaty as well as in Indian domestic law, including tax law and copyright act there is no mention of “copyright article” so there was no need to use of OECD Commentaries. The court also relied on hand book about copyright law issued by the Indian government.¹⁶¹

The most interesting points with regards to interpretation of tax treaties and the role of commentaries in non-OECD world were made in paragraph 124 of the case in which the court stated that while the OECD Commentaries is followed by OECD countries it can not be relied upon as

- 1.The OECD Commentaries is opinion of authors and can not be compared with an act of parliament or to case law
2. India has clear reservations on the Commentaries.

Furthermore the court noted that while the OECD view is that “copyright article” does not have copyright in it, during the working process there was also the view of minority disagreeing with the statement.¹⁶²The court also took an interesting position about interpretation of tax treaties in general. The court refused to take into consideration the argument of using Indian treaties with third

158M/s Microsoft Corporation vs Asst Director of Income-tax, M/s Gracemac Corporation vs Asst Director of Income-tax and Microsoft Regional Sales Corporation vs Assistant Director of Income-tax, International Tax Division, Circle 21(1) 2010-TII-141-ITAT-DEL-INTL (Judgment date – 26 October 2010) and see also KPMG in India Flash news 29 octomber 2010

159Ibid

160M/s Microsoft Corporation vs Asst Director of Income-tax, M/s Gracemac Corporation vs Asst Director of Income-tax and Microsoft Regional Sales Corporation vs Assistant Director of Income-tax, International Tax Division, Circle 21(1) 2010-TII-141-ITAT-DEL-INTL (Judgment date – 26 October 2010)

161 Ibid

162Ibid paragraph 124

countries concluded between 1996-2000 in which expression “computer software” was included in the definition of the royalty for interpreting India-US treaty concluded in 1976 in which the expression was missing. The court noted “ *We would also like to observe that we are not descending the issue relating to international law in relation of various treaties to which India is a signatory*” and concluded that as tax treaty is the result of individual negotiations between two states, US and India and therefore other tax treaties should not be taken into account. The court refused to use findings of the court in other case of Special Bench where based on the OECD Commentaries and US Regulations the Bench held that the copyright article does not have any copyright in it.¹⁶³ With this regard court referred to one of the decision of the supreme court and admitted:

*“ taxation policy is within the power of the Government and section 90 of the Income-tax act enables the Government to formulate its policy through treaties entered into by it and even such treaty treats the fiscal domicile in ones state or the other and thus prevails over the other provisions of the income-tax act it would be unnecessary to refer to the terms addressed in OECD commentary or in any of the decisions of foreign jurisdiction or in any other agreements ”*¹⁶⁴

Comment

The reasoning used by the court to reach its decision states that the OECD Commentaries is not an acceptable means for interpretation. It therefore seems that the court refused to use the reasoning found in Asia Satellite case in which the court mentioned that OECD meaning of technical term is an internationally accepted meaning and *always* a reliable source for interpretation. It also should be mentioned that this decision contradicts the decision in the Ericson case where the court admitted that US regulation and the OECD Commentaries have high persuasive value and therefore distinguished “Copyright article” from “Copyright”. So it can be concluded that in this case the court came to the conclusion that a persuasive value of the OECD Commentaries is not so 'high' and that the only possibility of using OECD Commentaries is when the definition is ambiguous.

In contrast to the decision in Asia Satellite case¹⁶⁵ from this Judgment it can be concluded that the fact that India set reservation on the Commentaries is important in tax treaty interpretation process.

Another interesting point was made about the issues of interpretation of tax treaties as well as about interrelation of domestic law and tax treaties. As some experts argue in this case can be seen the attempts of treaty overriding practice.¹⁶⁶

4.3 Summary – Case law of non-OECD States

The discussed case law demonstrates the importance of the OECD commentaries for the tax treaty interpretation. Even in Microsoft case where the court admitted that the Commentaries is unacceptable guide for interpretation the court mentioned possibility of using commentaries when the domestic law meaning is ambiguous.

The court considers the Commentaries as “framework document setting the common principles and

163 M/s Microsoft Corporation vs Asst Director of Income-tax, M/s Gracemac Corporation vs Asst Director of Income-tax and Microsoft Regional Sales Corporation vs Assistant Director of Income-tax, International Tax Division, Circle 21(1) 2010-TII-141-ITAT-DEL-INTL (Judgment date – 26 October 2010)

164Ibid paragraph 131

165High court of Delhi at New Delhi ITA No.131 of 2003 with ITA No.134 of 2003, date of decision 31 January, 2011

166 IBFD case summary and KPMG Flash news 29 october 2010

standards in order to eliminate double taxation” “document of persuasive value”, “always reliable source for interpretation” “international tax language”. From the reasoning of Russian court and the Indian court in Asia Satellite case it can be concluded that while not being binding, the Commentaries as internationally accepted document should always be reliable without further questions. At the same time, the Ericsson case considered the Commentaries at the same level as US regulations and grant to them a persuasive value. It can be concluded that the courts in each of the cases grant to Commentaries different “strength” depending on circumstances of cases. Russian and Indian court ignore the Vienna convention, in the case of India it can also be caused by the fact that India is not signatory of the Convention.

It was only in Fijian case¹⁶⁷ discussed above when the court considered the version of the commentary existing at the time of treaty binding under Article 31 of the Vienna Convention noting that the UK, as an OECD member has “reasonable expect” from Fiji that OECD Commentaries should be followed.

When it comes to use of the Commentaries the courts usually use ambulatory interpretation. The static interpretation is used only when there is reference to Article 31 of the convention. In regards to technical terms the latest version is generally used.

5. Can commentaries really play significant role in non-OECD world ? - practical problems of using foreign law

Apart from the legal debates about the status of commentaries and their role in tax treaty interpretation process, there can be some objective problems and difficulties of the use of the Commentaries in the non-OECD world. While it is argued that the globalization and the interest of trade and commerce require more open approach from judges¹⁶⁸ in practice the picture is far to be complete.

The multinational organizations involved in cross-border activities can not ignore challenges of the laws, which can be only overcome by help of comparative methodologies.¹⁶⁹ As it is argued the ideal situation for tax treaties interpretation is when they are interpreted in the uniform way, taking into the account other countries' case law evaluating the relevance of their decision.¹⁷⁰ As it is stated the aim of OECD commentaries, inter alia, is to support development of international fiscal law.¹⁷¹ The useful points with using “foreign law” when national law is contradictory, or need reform or clarification, is that some legal systems used to deal with specific issues more deeply.¹⁷² The expertise of the OECD in the field of international taxation can be useful for tax treaty interpretation. It is argued in regards to the UN convention of international sales of good which is also true for tax treaties that the main reason for the difficulties in interpretation process is that there is no international court which can make binding decision in the field. At the same time a reference

167Fiji, Civil appeal ABU 0022 of 1994

168Sir Basil Markesinis with Jorg Fedtke “Engaging With Foreign Law” Hart Publishing, Oxford and Portland, Oregon 2009 p.307

169Ibid 330

170Klaus Vogel on Double Taxation Conventions, Third Edition, A Commentary to the OECD, UN and U.S. Model Conventions for the Avoidance of Double Taxation of Income and Capital, With Particular Reference to German Treaty Practice, Kluwer law international, 1997 p.

171Introduction on the OECD Model Tax Convention on Income and Capital 2010 paragraph 29

172Sir Basil Markesinis with Jorg Fedtke “Engaging With Foreign Law” Hart Publishing, Oxford and Portland, Oregon 2009 p.320

to foreign law and practice can be limited due to accessibility of foreign material as well as due to differences in national legal traditions.¹⁷³

The problem of accessibility of materials is not new for the tax treaty interpretation. In 2006 it was mentioned that even the OECD member country - Poland had only few cases in which Polish courts were referring to the Commentaries. Furthermore it was argued that the courts in all cases used 1998 version of the Commentaries the only version available in Polish language by that time which at the end of the day could also lead to improper use of the Commentaries.¹⁷⁴ It also can be argued how taxpayers or tax courts can be required to use commentaries when there are no Commentaries available in non-member states' official languages, in certain cases the requirement of using the Commentaries that existed at the time of concluding treaty can make the picture more complicated.

The fact that the law is accessible does not mean that it should automatically be transported in other legal system, as it is argued sometimes the problem is not to find law but to understand and to evaluate it.¹⁷⁵ There is significant differences with the approaches towards using "foreign law". The common law tradition considers "foreign law" including referencing writings of famous scholars more important both in classrooms and courtrooms than continental law tradition.¹⁷⁶ Furthermore scholars distinguish German, French, English, and American models of approaching "foreign law". The issue is the matter of great importance as the most legal systems in the world are based on these legal traditions.¹⁷⁷

The empirical analysis of the tax treaty case law of non-OECD states also supports this conclusion. The countries referring to the OECD Commentaries are mostly common law countries, such as India and Fiji. These courts while coming to conclusion except of the Commentaries also evaluate writing of authors, other countries case law and foreign legislation (for example US regulations). The Fiji court to strengthen its reasoning points on UK case law as well as indicated that The court's findings "*had received the approval of the majority of commentators who had considered the provision*"¹⁷⁸ Indian court in the Ericsson case heavily relies on the OECD Commentaries and US regulation as on the argument of high persuasive value. In contrast in Russia, while a lot of foreign companies are involved in cross-border activities the above discussed case is the only case where the court referred to Commentaries. In addition in the above mentioned Russian case there is no reference on other countries case law as well as on any tax commentator by any parties involved in the dispute.¹⁷⁹

5.1 summary

In the current development of the international tax law the OECD Commentaries can most likely be considered as only a "soft law" not as a legally binding instrument. This means that it is not the fact that Judges would use the Commentaries as the argument of persuasive value in the process of

173Sir Basil Markesinis with Jorg Fedtke "Engaging With Foreign Law" Hart Publishing, Oxford and Portland, Oregon 2009 p.332

174 Dr. Wojciech Morawski and Dr. Adam Zalasinski " Tax treaty interpretation in the case law of polish courts" European taxation, november 2006 p. 540

175Sir Basil Markesinis with Jorg Fedtke "Engaging With Foreign Law" Hart Publishing, Oxford and Portland, Oregon 2009 p.356

176 Sir Basil Markesinis with Jorg Fedtke "Engaging With Foreign Law" Hart Publishing, Oxford and Portland, Oregon 2009 p.306

177Sir Basil Markesinis with Jorg Fedtke "Engaging With Foreign Law" Hart Publishing, Oxford and Portland, Oregon 2009

178Fiji, Civil appeal ABU 0022 of 1994

179Supreme Arbitrate Court of Russian Federation, case No.8654/11

tax treaty interpretation as they have generally no legal (maybe only moral) obligation to use it. Therefore the fact how in the country Judges usually consider foreign law and whether or not they have access to such materials is the decisive issue in order to evaluate the “law” properly in the tax treaty interpretation process between OECD and non-OECD states.

6. Final Conclusions

While there has been a lot of work done by the OECD to develop international fiscal relations and international fiscal law, states are still very cautious to give up their taxing sovereignty. There is no international court that has the authority to make binding decisions. The states' intention not to be bound with the Commentaries and the inconsistency in application of their observations on the Commentaries does not allow to consider the Commentaries to be more than “soft law”.

While the Commentaries can always be considered as a supplementary means of interpretation, as argued “*in contrast to the mandatory character of the general rule in Art 31, the use of supplementary means is basically left to the discretion of the interpreter*”¹⁸⁰

This means that the Commentaries is not *per se* legally binding in the course of tax treaty interpretation. At the same time, Articles 31 and 32 of the Vienna Convention as well as Article 3(2) of the OECD Model appealing on the context of the treaty indirectly refer back to the Commentaries. This thesis suggests that the role of the Commentaries should be only determined by the courts on case-by-case basis; bringing together ordinary meaning, context, good faith, object and purpose of the treaty granting to the Commentaries the weight that it deserves in each particular case. Thus, it is only courts that as Pijl notes can move the Commentaries “*to a more definite international order*”.¹⁸¹

With regard to non-OECD countries with official position and without official position, it can be concluded that non-OECD countries which set official position on the Commentaries have more political and moral obligation to follow their position than countries that do not set any position and with this regard the persuasive value of the Commentaries can be different.

The discussed case law of non-OECD states also demonstrates that while generally the courts use the Commentaries, they grant the Commentaries a different value in each particular case. The value can differ from the “*unacceptable aid for interpretation*”¹⁸² to the “*always reliable source for interpretation*”¹⁸³.

With regard to certain tax treaties with special reference to the Commentaries as it fairly argued, is a step forward to the direction of more certainty on the role of the Commentaries for tax treaty interpretation and increasing the legal status of the Commentaries.¹⁸⁴

As the role of the Commentaries is to be determined on case-by-case basis, the legal tradition of the state applying the treaty as well as accessibility to OECD materials can also have a great impact on the role of the Commentaries. The analysis of the above discussed case law and the literature about the role of “foreign law” also support this conclusion.

180 Dörr, Oliver, Schmalenbach, Kirsten (eds), *Vienna Convention on the Law of Treaties: a commentary* (Springer Berlin Heidelberg Dordrecht London New York 2012) p.582

181 Hans Pijl, “The OECD Commentary, As a Source of International Law and the Role of the Judiciary” *European taxation*, May 2006 p.221

182 *M/s Microsoft Corporation vs Asst Director of Income-tax, M/s Gracemac Corporation vs Asst Director of Income-tax and Microsoft Regional Sales Corporation vs Assistant Director of Income-tax*, International Tax Division, Circle 21(1) 2010-TII-141-ITAT-DEL-INTL (Judgment date – 26 October 2010)

183 High court of Delhi at New Delhi ITA No.131 of 2003 with ITA No.134 of 2003, date of decision 31 January, 2011

184 John Avery Jones, “Are tax treaties necessary” 53 *Tax L.Rev* 1 1999-2000 p20

This thesis concludes that the status and role of the Commentaries can be determined only by the Courts on case-by-case and can differ state-by-state and any attempts to find some universal approach about the role of the Commentaries in the current development of international tax law is analogous to *squaring the circle*.

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