

**2009 IFA TRAVELLING LECTURESHIP ON ROYALTIES BY NATHAN BOIDMAN
APPENDICES TO LECTURE OUTLINE**

APPENDIX 31

(DAVID WARD ON THE ROLE OF OECD MODEL TREATY COMMENTARIES)

Material:

David A. Ward, Luc De Broe, Juergen Killius, Jean-Pierre Le Gall, Toshio Miyatake, Kees van Raad, John F. Avery Jones, Maarten J. Ellis, Sanford H. Goldberg, Guglielmo Maisto, Henri Torrione, and Bertil Wiman, "The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries on the OECD Model", *International Fiscal Association* (Canadian Branch) and *International Bureau of Fiscal Documentation*, 2005, p. 4-5 (overview of the question) and 110-114 (views on later commentaries).

The question has often been raised: what is the proper role of the commentaries in the process of interpreting tax treaties?⁹ Although the subject has

9. This has been discussed extensively in various articles and tax treaty treatises. Some, but not all, include John F. Avery Jones *et al.*, "The Interpretation of Tax Treaties With Particular Reference to Article 3(2) of the OECD Model", [1984] *Br. Tax Rev.* 14 and 90 (herein "Avery Jones *et al.* Interpretation"); Frank Engelen, *Interpretation of Tax Treaties Under International Law*, (IBFD, Amsterdam, 2005) (herein "Engelen"); Vogel *et al.*, note 7, Introduction at paragraph 78 *et seq.*; Philip Baker, *Double Taxation Conventions*, (Thomson/Sweet & Maxwell, London, looseleaf) (herein "Baker"); Michael Edwardes-Ker, *Tax Treaty Interpretation*, (Alpha Print, Athlone, Ireland, looseleaf) (herein "Edwardes-Ker") at chapter 26; Klaus Vogel and Rainer G. Prokisch, general reporters, *Interpretation of Double Taxation Conventions*, Vol. LXXVIIIa cahiers de droit fiscal international (IFA, 1993) (herein "Vogel and Prokisch") at 64 *et seq.* and the various National Reports in that cahier; David Ward, *Ward's Tax Treaties 1996-1997*, (Carswell, Toronto, 1996) (herein "Ward") at 37 *et seq.*; Klaus Vogel, "Double Tax Treaties and Their Interpretation", 4:1 *International Tax & Business Lawyer* (1986) (herein "Vogel") at 39 *et seq.*; Ault, note 7 at 61; François Vincent, "Crown Forest Industries: The OECD Model Tax Convention as an Interpretive Tool for Canada's Tax Conventions" (1996), 44 *Can. Tax J.* 38; J. van Soest, "Use of Tax Treaties in Supreme Court

1. Introduction

been well-canvassed by various commentators, including some of the authors of this article, because there does not seem to be a consensus on the legal role that the commentaries can play in the interpretive process, it appeared appropriate to the authors to consider this important subject again. As is the case with the commentaries themselves, we have not arrived at unanimity in our views. What we express as our views in this article should be understood by the reader to be a wide, but not always full agreement of the authors.

In our consideration of this matter, we first summarize the work of the OECD Committee on Fiscal Affairs and its role in developing and amending the Model and the commentaries. We then review the question of how the commentaries should be applied in interpreting bi-lateral tax treaties in accordance with the interpretive rules of the *Vienna Convention on the Law of Treaties* and how the commentaries may be used to determine the intention of tax treaty negotiators in relation to the meaning of tax treaty provisions adopted by them from the Model. We then consider whether, in international law, the explanations of the meanings of various Articles of the Model as expressed by the commentaries become binding interpretations on OECD member states in international law and domestic or municipal law. We then turn to a consideration of the proper effect in the interpretive process of the various observations on the commentaries entered by member states. Next we consider the proper role of commentaries published after a bi-lateral tax treaty has been negotiated and has entered into force. Finally we express and summarize our conclusions respecting the role of the commentaries in the interpretive process.

Cassation in The Netherlands”, 1996 *European Taxation*; Richard Krever and Jason Chang, “Australian Court Scrutinizes OECD Model Treaty Provisions on the Alienation of Real Property”, 1997 *Tax Notes International* 1187; Richard Vann, “Interpretation of Treaties in New Holland” in *A Tax Globalist: Essays in Honour of Maarten J. Ellis* (IBFD, Amsterdam, 2005) at 144 (herein “Vann”); Michael Lang, “Later Commentaries of the OECD Committee on Fiscal Affairs, Not to Affect the Interpretation of Previously Concluded Tax Treaties” (1997), 25 *Intertax* 7 (herein “Lang”); the various authors in *Tax Treaty Interpretation*, Michael Lang ed. (Kluwer, The Hague, London and Boston 2001) (herein “Tax Treaty Interpretation”); Jimenez, note 7 at 17; Ekkehart Reimer, “Interpretation of Tax Treaties”, 1999 *European Taxation* 458 (herein “Reimer”) at 467 *et seq.*; Peter J. Wattel and Otto Marres, “The Legal Status of the OECD Commentary and Static or Ambulatory Interpretation of Tax Treaties”, 2003 *European Taxation* 222 (herein “Wattel and Marres”); Justice Graham Hill, “The Interpretation of Double Taxation Agreements — The Australian Experience”, 57 *Bulletin for International Fiscal Documentation*, 320 (2003) (herein “Hill”); Frank van Brunschot, “The Judiciary and the OECD Model Convention and its Commentaries”, 59 *Bulletin for International Fiscal Documentation*, 5 (2005) (herein “van Brunschot”); Waters, note 8; and Mattias Dahlberg, *Svensk Skatteavtalpolitik och utländska basbolag*, (Iustus Forl AG, Uppsals, Sweden, 2000) at 60-101.

(d) *Our views on later commentaries*

Although the practical approach that Waters outlines and uses as support for the relevancy of later commentaries may be interesting, he accepts that commentaries including later commentaries are not binding on taxpayers and courts and thereby acknowledges that the later commentaries do not have the force of law either on an international level or on a national or municipal law level. We agree. In our view, it is a question, therefore, of the weight to be given to later commentaries in interpreting pre-existing treaties. Subsequent commentaries that elaborate on prior commentaries and are fair interpretations of the articles of the Model may be useful in the interpretive process. However, it is questionable how useful they may be, or what they may add in many cases when the articles of the treaty are interpreted in accordance with Article 31 of the *Vienna Convention*, with the aid of prior commentaries in accordance with the principles of logic and good sense. In our view there is little or no legal justification for the use of such commentaries where they fill gaps in the Model by purporting to fill gaps in the commentaries. If there is a gap in the Model, the only appropriate way to fill the gap would be to amend the Model and, in respect of a pre-existing treaty, the appropriate way, following the rule of law, would be to amend the treaty by a protocol or the negotiation of a new treaty, the wording of which clearly fills the gap. In the case of commentaries that follow state practices under existing treaties, if these state practices are in fact adopted by the two states to any particular treaty and if the state practice "establishes the agreement of the parties regarding its interpretation" and is a genuine interpretation and not effectively a change in the treaty, the subsequent practice forms one of the elements in the general rule

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of interpretation of Article 31(3)(b) of the *Vienna Convention* and may have effect under international law.²⁹¹ Further, a change in the commentaries does not necessarily evidence a state practice of any particular OECD member state, or any two member states. More evidence than a change in the commentaries should be provided before Article 31(3)(b) of the *Vienna Convention* can be applied and this may be difficult to obtain because assessments of taxes are usually confidential as between particular taxpayers and the taxing authorities. Also the commentaries often refer to diverging practices.²⁹² We also are of the view that later commentary contradicting previous commentary should never be taken into account in interpreting existing treaties. To do so would be to deny the effectiveness of existing OECD commentary as part of the legal context in establishing the intentions of the parties negotiating particular tax treaties based on the commentaries and the Model current at the time and to delegate to the CFA an international law-making capacity for which there is no support. In short, later commentaries that go beyond a fair interpretation of the text of the particular treaty should be given little or no weight by national courts dealing with the interpretation and application of pre-existing treaties.

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In our view, most of the OECD commentaries do not fit easily within the general rule of interpretation or the supplementary means of interpretation in Articles 31 and 32 of the *Vienna Convention*. The exception is to the extent the commentaries can be shown to have been intended by the treaty parties to provide a special meaning of such a term, the commentaries would be relevant in providing the meaning of the term when applying paragraph (4) of Article 31 of the *Vienna Convention* in the interpretive process.

Even though much of the commentaries does not fit within the interpretive rules of the *Vienna Convention*, it should be recognized that the interpretive rules described in Articles 31 and 32 are not a complete statement of all

291. A state practice also raises questions of effectiveness under municipal law if it actually changes pre-existing treaties.

292. See, for example, paragraphs 9.2 and 9.3 of the commentary on Article 1, paragraph 6 of the commentary on Article 5, paragraph 2.1 of the commentary on Article 15, paragraph 1.1 of the commentary on Article 16 and paragraph 8 of the commentary on Article 18. Also the commentary uses such expressions as, "Member States have generally ...", in referring to state practices and there is even an example of an error in referring to state practices. The Belgian tax authority took the position before the Belgium Supreme Court that Article 3(2) should be applied in a static way: Supreme Court decision, 21 December, 1990, Pas., I, 402, contrary to paragraph 13.1 of the commentary to Article 3(2) added in 1995.

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the principles and maxims of interpretation that are found in decisions of international tribunals as these were intentionally not codified by the International Law Commission as their application is discretionary rather than obligatory. These uncodified principles and maxims which have been described in the *Vienna Convention* commentaries as principles of logic and good sense have been recognized as valuable guides to assist in appreciating the meaning which the parties may have intended to attach to expressions that they employed in treaties. As Sinclair has stated, no would-be interpreter of the treaty will deliberately ignore any material which can usefully serve as a guide towards establishing the meaning of the text with which he is confronted. Accordingly, much of the commentaries, in our view, can be given a proper and effective role in accordance with principles of logic and good sense in the interpretive process in dealing with bilateral income tax conventions as the commentaries, as they existed at the time of the conclusion of a bilateral treaty formed part of the legal context of the treaty and can be presumed to reflect the intended interpretation of the treaty articles that follow the OECD Model. This presumption is strongest with bilateral treaties between member states of the OECD. If the commentaries go beyond a fair interpretation of the provisions of the Model and of a bilateral tax treaty that adopts the wording of the Model, because of the importance of interpreting treaties in accordance with their terms, legitimate questions can arise as to whether such commentaries should be adopted in interpreting the treaty.

It is our view, as well, that where an undefined treaty term is explained or defined in the commentary existing at the time the treaty was concluded, although it may also have a particular meaning in the internal law of the state applying the treaty,²⁹³ as the meaning in the commentary may be said to be part of the context of the treaty, if the relevant commentary is unambiguous in the meaning it ascribes to the term we are of the view that the internal law definition could be ignored and the commentary then would govern the interpretation of the undefined term.

In dealing with bilateral tax treaties made between two states one or both of which is or are not members of the OECD, the commentaries have lesser value in the interpretive process, particularly if the non-member state or states is or are not included amongst the 25 states that have been provided with an opportunity to record their positions on the various articles and commentary on the Model. However even in a case where the non-member

293. And thereby is to be given the meaning that it has under internal law unless the context otherwise requires in accordance with Article 3(2) of the Model.

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state has had this opportunity to express its views, the commentaries may have lesser weight because such non-member state has not had the opportunity to participate in the discussions and the formulation of the commentaries themselves.²⁹⁴

In determining what commentary should be considered in accordance with the principles of logic and good sense in interpreting bilateral tax treaties, it is our view that the commentary should be limited to that which had been adopted by the CFA and the OECD Council and published prior to the conclusion of the bilateral treaty in question. Drafts of new commentaries and OECD reports that precede such drafts even if existing when the bilateral treaty is concluded should not be considered to have been part of the legal context and not be considered to indicate the intentions of the parties to the bilateral treaty at the time of its conclusion unless the treaty parties otherwise agree in a protocol or a memorandum of understanding.

We are also of the view that the commentaries do not rise to the level of binding interpretations in international law and although they are obviously helpful and important in the interpretive process, they may not be binding on tax administrations in municipal or internal law, and certainly are not binding on taxpayers or the courts.

When one of the two states concluding a bilateral treaty has entered a relevant observation on the commentary on a particular article of the Model and that article has been adopted by the two states in their bilateral income tax treaty, the effect of the observation has not been clarified by the OECD. In our view, if the commentary relates to the meaning of a treaty term and if the observation advances an alternate interpretation, it would be reasonable to apply the treaty on an asymmetrical basis in a way similar to the application of the treaty where an undefined treaty term is given a different definition in each of the two states on the application of Article 3(2) of the Model. In this respect, the state of source of income applies the treaty term in accordance with the meaning that it has accepted, the other state should accept the correctness of that interpretation and allow relief under the equivalent of Articles 23A and 23B of the Model. Where, however, the provision of the treaty requires there to be a single symmetrical interpretation, such as Articles 4(2) and 7(2), the issue as to which is the correct interpretation would presumably have to be established by mutual agreement procedures or in the courts disregarding both the commentary and the observation entered on the commentary. In cases where the observation is

294. China has expressly stated that it will not be bound by its stated positions.

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to more general commentary such as in those cases where the observation is in relation to the 2003 anti-abuse commentary on Article 1, the observation should be interpreted as a statement by the observing state that it does not agree to the application by the non-observing state of the anti-abuse rule or rules or principles other than those that have been expressly included in the bilateral treaty. An asymmetrical application of anti-abuse rules would be inappropriate in these cases as the application of such anti-abuse rules has not been supported by any consensus of the parties. In dealing with treaties concluded before the anti-abuse commentary in question was adopted by Council, the issue of whether anti-avoidance rules should be applied even though not expressly included in the treaty should be determined on the basis of the commentary and observations that existed and had been published when the particular treaty was concluded.

Commentaries that have been adopted by the CFA and the Council and published after the conclusion of a bilateral tax treaty may be considered in the interpretive process. In this respect such later commentaries should be carefully evaluated to determine to what extent, if any, the commentaries, if applied, would shift or alter the meaning of the bilateral tax treaty provision in question and if such later commentaries are considered to change the meaning of an existing bilateral treaty, they should not be applied.