INTRODUCTION

I. THE IMPACT OF THE OECD COMMENTARY ON NATIONAL JUDICIAL INTERPRETATION

The Commentary to the OECD Model Tax Convention on Income and on Capital (hereinafter respectively the ‘Commentary’, and the ‘Model’ or ‘Convention’\(^1\)) in its Introduction summarizes the evolution to define a model for specific double tax convention concluded by States on a bilateral basis (hereinafter the ‘treaties’). The work by international law scholars commenced in 1921 by the League of Nations, which in 1928 issued the first model, followed by the Model Treaties of Mexico (1943) and London (1946). The Council of the Organisation for European Economic Co-operation (OEEC) issued the first Recommendation concerning double taxation on 25 February 1955, and from 1958 to 1961, the Fiscal Committee released four interim Reports, which lead in 1963 to the Draft Double Taxation Convention on Income and Capital, taking the form of a recommendation by the Council 30 July 1963, to conform to that Draft Convention.\(^2\)

The elaboration of standards then shifted to the OECD, which is a forum where governments can compare policy experiences, seek answers to common

problems, identify good practices and work to co-ordinate domestic and international policies.³

I.03 In 1977 a new Model Convention and Commentaries were released by the OECD. Working Party No. 1 prepared reports, related to the 1977 Model Convention and recommended amendments. In 1991, the Committee on Fiscal Affairs (hereinafter the ‘CFA’) adopted the concept of an ambulatory Model and Commentary to which periodic updates and amendments are regularly made. This revision process enabled input from non-Member countries, other international organizations, and other interested parties. In 1992 the OECD released a Model Convention in a loose-leaf format, which was the first step of an ongoing revision process and which constitutes in the proper sense the Model on which this book is focused. In 1997, the Committee on Fiscal Affairs added positions of non-Member countries.⁴

I.04 The Model has become the standard of reference of application of bilateral treaties effectively entered to by countries. The main purpose of the Model is the application by all countries of common solutions to identical cases of double taxation. The recommendation by the Council of the OECD, expressly states:

Member countries, should conform to this Model Convention as interpreted by the Commentaries thereon and having regard to the reservations contained therein and their tax authorities should follow these Commentaries, as modified from time to time and subject to their observations thereon, when applying and interpreting the provisions of their bilateral tax treaties that are based on the Model Convention.⁵

I.05 The Commentary or other OECD reports and documents constituting ‘soft tax law’ are often implemented in the domestic tax systems by legislative measures or administrative guidelines that essentially transplant OECD policies. For example, tax treaties often reproduce the exact wording of the clauses of the Model, while Tax Authorities have implemented the OECD cost-sharing and transfer pricing policies in regulations and other normative documents.

⁵ Commentary, Introduction § 3.
I. THE IMPACT OF THE OECD COMMENTARY ON NATIONAL JUDICIAL INTERPRETATION

There is no doubt that the Model has a primary impact on the negotiation and development of tax treaties entered into by individual countries. According to the Introduction to the Commentary since 1963, the Model has had wide repercussions on the negotiation, application, and interpretation of tax treaties. OECD Member countries have largely conformed to the Model when concluding or revising bilateral treaties. The Commentary also notes that the impact of the Model Convention has extended beyond the OECD area. It has been used as a basic document of reference in negotiations between Member and non-Member countries and among non-Member countries, as well as in the work of other worldwide or regional international organizations in the field of double taxation and related problems. The Model is used as the basis for the original drafting and the subsequent revision of the United Nations Model Double Taxation Convention between Developed and Developing Countries.

The Model is a Convention-Model and is accompanied by the extensive Commentary, a document issued by the CFA which provides an explication and interpretation of the Model. As the Commentary has been drafted and agreed upon by the experts appointed to the CFA by the governments of Member countries, it is of special importance in the development of international tax law.

Convergence or divergence in respect to the Model is achieved at the level of individual treaties concluded by countries through the adoption of provisions that are, or are not, based on the Model. One should however bear in mind that convergence or divergence in respect of the Model can also be achieved through law-in-action, for example through judicial decisions or administrative guidelines which may be ‘inspired by’ or ‘refer to’ the Commentary.

The impact of the Commentary on actual approaches taken by domestic tax courts is currently being debated and this book shows that convergence or divergence in respect to the Model can also be achieved through law-in-action, for example through judicial decisions or administrative guidelines which may be ‘inspired by’ or ‘refer to’ the Commentary.

---

6 Commentary, Introduction § 12.
7 Commentary, Introduction § 14.
8 See for example: Michael Lang et al. (eds), The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties (Cambridge University Press 2012).
INTRODUCTION

divergence in respect to the Model is often achieved through judicial interpretation when national Courts use the Commentary to interpret the treaties. So there can be situations in which the same provision of different individual treaties, modelled after the Model, are interpreted differently by national Courts, leading to divergent outcomes. By the same token there can be situations in which different provisions of different individual treaties which diverge from the Model, are interpreted uniformly by national Courts leading to convergent outcomes.

I.10 The OECD has taken a very pro-active position on the role of the Commentary on treaty interpretation. For example, according to the OECD ‘the tax administrations of Member countries routinely consult the Commentaries in their interpretation of bilateral tax treaties’ and ‘tax officials give great weight to the guidance contained in the Commentaries’.10 Moreover, in the view of the OECD, ‘taxpayers make extensive use of the Commentaries in conducting their businesses and planning their business transactions and investments’.11

I.11 These statements raise an important question that has a twofold aspect: (i) normatively, whether the Commentary should have a binding impact on national tax authorities, and; (ii) descriptively, how and to what an extent such an impact has unfolded in countries’ practices. An additional research question is whether and to what extent the Commentary creates rights or duties of taxpayers in their domestic tax systems. An additional important issue is how judges use the Commentary in their domestic tax systems. This book is aimed at addressing these questions by identifying what is the exact use of the Commentary in judicial application of tax treaties – often based on the Model – by national Courts.

I.12 According to the OECD:

courts are increasingly using the Commentaries in reaching their decisions. Commentaries have been cited in the published decisions of the courts of the great majority of Member countries. In many decisions, the Commentaries have been extensively quoted and analysed, and have frequently played a key role in the judge’s deliberations.12

I.13 In spite of the fact that the CFA ‘expects this trend to continue as the world-wide network of tax treaties continues to grow and as the Commentaries gain even more widespread acceptance as an important interpretative

10 Commentary, Introduction § 29.1.
11 Commentary, Introduction § 29.2.
12 Commentary, Introduction § 29.3.
I. THE IMPACT OF THE OECD COMMENTARY ON NATIONAL JUDICIAL INTERPRETATION

reference', one should assess whether this is really the case. There is a need to review accurately to what extent and how the Commentary has an impact at the level of domestic internalization. This can be done relying on the transnational legal process approach. More precisely the main focus of this study revolves around interpretive techniques adopted by national Court when using the Commentary in interpreting of tax treaties.

The key question is exactly how the courts use the Commentaries, whether to abide by the OECD position to advance local solutions or to pursue other goals. The book describes this by following the structure of the Commentary through a detailed outline and provides a description of local judicial solutions. Even if there is no doubt that the Commentary is ‘referred to’ or ‘used’ by national judges in applying the treaties, the interpretive solutions advanced by the Commentary are not strictly binding on them. For example, according to the Model:

Although the Commentaries are not designed to be annexed in any manner to the treaties 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 treaties and, in particular, in the settlement of any disputes.14

A few definitional remarks are required at the outset to clearly define the scope of the research about judicial use of the Commentary conducted in this book.

The first remark is that the Model is viewed as a set of rules or norms (often allocation rules) which are generally posed in a conditional form (such as if F, then G) and often are subject to multiple detailed requirements arranged in a complex structure [such as if F, and (F2 or F3) but not F4, then G] so that one of the purposes of the Commentary is to attribute a certain meaning to the rules of the Model.15 The ‘interpretation’ of the Model by the Commentary is meant here to be the attribution by the Commentary of a meaning to the text of rule included in the Model.16 This attribution of a meaning leads to a so-called ‘interpretive solution’ which is advanced in the Commentary.

13 Ibid.
14 Commentary, Introduction § 29.
15 A structure like that is found for example in Art. 15 of the Model.
16 The term ‘interpretation’ in American neo-constitutionalism and generally in the Anglo-Saxon legal tradition is often used with a wider, and more vague, meaning; see for example Ronald Dworkin, Law’s Empire (Cambridge, MA: Harvard University Press 1986). That approach to ‘interpretation’ is not used in this chapter.
This approach to interpretive solutions advanced in the Commentary, however, does not imply a full interpretive scepticism according to which interpretation can lead to any outcome: according to a well-established approach there is a framework of potential interpretive solutions available, from which the judge in an individual domestic tax system can select one by using particular ‘interpretive techniques’ based on clusters or arrangements of ‘arguments’ that essentially advocate the persuasiveness of the interpretive outcome.17

The second remark is that a given interpretive solution advanced by the Commentary does not ‘reveal’ the actual, unique and pre-existing meaning of the rule of the Model, so a distinction is made between the ‘text’ of a rule of the Model in prescriptive language and the ‘meaning’ of that rule which is attributed by the Commentary, which amounts to an interpretive solution, it being understood that such an interpretive solution is one of many potentially available outcomes of diversified competing interpretive strategies which may also emerge at national judicial level.

The third remark is that the interpretive solutions advanced by the Commentary often take the form of ‘principles’ which are not posed in a conditional form (like the rules of the Model), but rather: (i) have a ‘foundational’ nature; and (ii) are indeterminate in their scope. The ‘foundational nature’ of those principles of the Commentary is that they are value-based. The ‘indeterminacy’ of principles of the Commentary has three features. First, the scope of principles is not subject to requirements enumerated ex ante. Second, principles are defeasible, in the sense that the list of derogations is open-ended. Third, principles are non self-executing in so far as they require other norms to be applied, or because they express policies that can be applied in different/alternative ways.

There are many instances of these principles within the Commentary and it is left to the reader to identify them; the following is just an example of such principles. The Commentary to Art. 1, discussing the treaty entitlement of partnerships, provides that if the partnership is treated as a company resident of the country where profits are produced and is ‘liable to tax’ therein (Art. 4 § 1), then the partnership is entitled to treaty benefits as a person, for example, the profits are subject to the dividends article when distributed.18 This principle has a ‘foundational nature’ because it establishes a norm on the basis of a practical value. This principle is also ‘indeterminate’ because: (i) its scope is

---

18 Commentary to Art. 1 § 5.
not subject to requirements enumerated \textit{ex ante} but potentially applies to an indeterminate set of situations; (ii) is defeasible because the list of derogations is open-ended; and (iii) is non self-executing because it expresses a policy that can be applied in different/alternative ways.

Finally it should be noted that the Commentary does not always provide interpretive solutions or principles as in many instances it simply suggests \textit{alternative policies} which may be adopted by States thereby not creating any binding principle. Here are a few examples. The Commentary to Art. 1 addresses the issues raised by the current treatment of Collective Investment Vehicles (CIVs) and advances five approaches proposing possible treaty clauses. Likewise the Commentary addresses the policy issues raised by improper use of the treaties and advances five approaches proposing treaty clauses (look-through approach; subject-to-tax approach; channel approach; \textit{bona fide} safeguard clauses; and limitation-of-benefits approach).

In a more general way the Commentary to Art. 18 on pensions evaluates different alternative provisions which can be adopted to deal with the misalignment of national systems. With regard to royalties, the Commentary observes that Art. 12 § 2 requires that software be classified as a literary, artistic or scientific work, but also notes that none of these categories is entirely apt, and for this reason the copyright laws of many countries specifically classify software as a \textit{literary or scientific work}. This issue has been addressed in particular in cases decided in Spain.

Another example of policy discussion by the Commentary is whether dividends received by a permanent establishment (hereinafter 'PE') in the source-country (hereinafter the 'SC') in respect of participations owned by that PE in foreign companies, should be subject, in the same SC, to the same treatment afforded to dividends received by domestic companies in the SC in respect of participations owned by those companies in foreign companies. The Commentary does not take a position and weighs the arguments for and against the extension of dividends exemption to PEs.

19 Commentary to Art. 1 §§ 6.8–6.34.
20 Commentary to Art. 1 §§ 13–20.
21 Commentary to Art. 18 §§ 12–21.
22 Commentary to Art. 12 § 12.2.
24 Commentary to Art. 24 § 48–54.
II. DOMESTIC JUDICIAL TRANSPLANTS OF OECD INTERPRETIVE SOLUTIONS OR PRINCIPLES

I.23 The conclusion of the previous section is that interpretive solutions or principles advanced by the Commentary are among those that can be considered by local judges in the application and interpretation of specific treaties. So the question is how this occurs. A way to approach this problem is to posit that OECD interpretive solutions or principles may circulate through ‘judicial transplants’ activated by domestic courts.

I.24 In a broad sense judicial transplants occur when interpretive solutions or principles are imported from a given source, which can be a domestic tax system or an authoritative international authority (‘source’) into one or more countries (‘destination’) through the judicial position taken by their domestic courts. For example the tax courts of one country can accept judicial principles developed by case law in another country, and this can be done explicitly by citing the foreign judicial authority.

I.25 In this perspective the courts of one or more countries (‘destination’) can be said to import the interpretive solutions or principles advanced by the Commentary, which is thus considered to be the international source of reference of national judicial solutions. One therefore needs to place the transplant by national judges of interpretive solutions or principles of the Commentary within a wider model of the trans-national legal process. This model, in a broad manner, looks at how public/private actors interact in various fora at domestic and international level to make, interpret, apply, enforce and internalize international norms, in our case OECD interpretive solutions or principles as reflected in bilateral tax treaties.

I.26 When several countries are involved in a process that may span several decades the pathways of diffusion of judicial transplants may be complex and indirect and influences may be reciprocal. Moreover, judicial transplants of OECD interpretive solutions or principles may take place through informal interactions among judiciaries without involving formal adoption or enactment of foreign decisions. In these cases diffusion occurs through a drawn-out process, which, even if there were some critical moments, cannot be understood without reference to events that may have occurred before or after such moments.

I.27 More importantly, the idea that imported OECD interpretive solutions or principles retain their identity in the transplanting domestic tax system without significant change is often misleading, as one is often faced with
II. DOMESTIC JUDICIAL TRANSPLANTS OF OECD INTERPRETIVE SOLUTIONS OR PRINCIPLES

locally-idiosyncratic modifications of the original purpose of the imported interpretive solution or principle.25 Important qualifications of this model of judicial transplants of OECD interpretive solutions or principles are also that: (i) diffusion of these interpretive solutions or principles may take place between many kinds of legal orders at and across different geographical levels and not just horizontally between national tax systems; and (ii) formal governmental institutions are not the only agents of diffusion of those solutions because of the operation of networks, epistemic communities and local elites.

The study of judicial transplants of OECD interpretive solutions or principles enriched by these qualifications shows that change in domestic tax systems is often the result of a wide global process of circulation of such solutions, and that comparative analysis is meaningful in so far as it detects which characters of a given interpretive solution or principle have developed domestically and which have developed through judicial transplants using the Commentary as source. As noted above, this analysis provides a ‘conjectural history’ of national interpretive solutions or principles adopted in a given country by domestic judges because it connects them to interpretive solutions or principles previously developed at the level of the source, the Commentary.

The fact that judicial transplants are an important vehicle for the circulation of OECD interpretive solutions or principles thus highlights three important features. First, judicial transplants can create convergence as well as divergence among different domestic tax systems. Secondly, when judicial transplants create convergence, they may contribute to the explanation of common features of domestic tax systems based on the Commentary. Thirdly, when judicial transplants create divergence, they may contribute to the explanation of how competition among national judicial solutions unfolds in spite of the uniforming solution (if any) advanced by the Commentary. Finally, judicial transplants by national Courts of OECD interpretive solutions or principles offer a strong challenge to the idea that tax laws are exclusively a local response to social demands felt by specific national communities.

In the taxonomy proposed here there are two basic types of domestic judicial transplants of OECD interpretive solutions or principles: effective judicial transplants which operate as vehicles of judicial convergence, and hybrid judicial transplants which operate as vehicles of judicial divergence.

A. Effective judicial transplants as vehicles of judicial convergence

I.31 Effective judicial transplants occur when the source OECD judicial interpretive solutions or principles are imported into one or more destination countries through judicial decisions retaining the OECD purported meaning. In these cases the OECD interpretive solution imported into the destination countries has a common origin as it comes from an identified source (the Commentary), and has the same content, as it retains the content originally found in the source. In this situation, after the judicial transplant, the interpretive solution adopted in the importing countries is the same as that proposed at OECD level, so one can safely say that judges have faithfully aligned to an external interpretive solution or principle.

I.32 Canadian cases offer good examples of effective judicial transplants of OECD judicial interpretive solutions or principles. For example, in the leading case Prévost, the Court noted that a definition of ‘beneficial ownership’ could be interpreted in the light of the OECD Conduit Companies Report and the Commentary.26 In other cases Courts have addressed situations in which the issue was whether a taxpayer was effectively liable to tax and therefore entitled to the benefits of the treaty. For example in TD Securities the Court held that the expression ‘liable to tax’ had to be interpreted, according to § 8 Commentary, as the description of those who are subject to a comprehensive taxation (i.e. full liability to tax).27 In Garcia the taxpayer was a dual resident and the Court applied the tie-break rules of the residence article, relying on §§ 11, 12 and 13 of the 2005 Commentary.28

I.33 Knights of Columbus, a case about the concept right of use test to determine whether there is a PE, relied on § 4.3 of the Commentary to Art. 5 about the supervising work by the parent company where it affirms that this situation occurs when, for example, employees of a company are allowed (for a sufficiently long period of time) to use an office in the headquarters of another company to ensure that the company complies with contracts.29 Likewise in American Income Life Insurance the Court referred to § 38 of the Commentary to Art. 5 (detailed instructions) and § 38.3 Commentary (responsibility to his

26 Canada, Tax Court of Canada, Prévost Car Inc. v. Her Majesty the Queen, 22 April 2008, 2008 TCC 231.
II. DOMESTIC JUDICIAL TRANSPLANTS OF OECD INTERPRETIVE SOLUTIONS OR PRINCIPLES

principal for the results of work) to evaluate legal and economic indicators of independence.\(^{30}\)

These cases are typical examples of judicial transplants of OECD interpretive solutions or principles because, in their reception by domestic courts, Commentary paragraphs are cited and faithfully followed. It should, however, be pointed out that these judicial transplants just constitute a paradigm case in which reception involves a direct one-way transfer from the source to the destination carried out by Courts through the formal enactment of judicial decisions. This paradigm case also assumes that the object of reception retains its identity without significant change after the date of reception. Because of this set of very strict assumptions, straightforward judicial transplants of OECD interpretive solutions or principles are rarely found in reality.

B. Hybrid judicial transplants as vehicles of judicial divergence

By contrast, *hybrid judicial transplants* of OECD interpretive solutions or principles are a peculiar type of transplants that should be distinguished from effective judicial transplants of those solutions. In hybrid judicial transplants the imported OECD interpretive solution is modified substantially in the process of being transplanted by judges in a given domestic tax system. In this case, the judicial transplant leads to an interpretive solution or principle at national level that is different from that advanced by the Commentary.

In hybrid judicial transplants, the interpretive solutions or principles adopted in the destination countries do have a common origin as they both come from the same source institution (the Commentary), yet they do not have a common content, because the transplanted solution is modified in a relevant aspect and thus acquires a *new content*. In practice in these hybrid judicial transplants the transplant is used as a vehicle, sometimes even as a mere pretext, for domestic change.

Hybrid judicial transplants are identified through the internal perspective of each individual tax system on a case-by-case basis. What follows are merely examples of hybrid judicial transplants, which in effect constitute an underlying force in the internalization process of OECD the interpretive solutions or principles that unfold in manifold manifestations.

---

Judicial applications of the Commentary to Art. 5 provide good examples of hybrid judicial transplants which express the pressure by national Courts to protect the interest of the source-country. For example in respect to preparatory/auxiliary activities the Commentary observes that under the exception provided by Art. 5 § 3, activities carried out through a fixed place of business, are not PEs if these activities are ‘remote’ from the actual realization of profits, but there is a restrictive judicial trend by national Courts to include in core activities the preparatory or auxiliary natures of activities carried on through a fixed place of business.31 Likewise: storage space falls under this exception of Art. 5 § 3 a) but there is a restrictive judicial trend which denies that storage space, as such, constitutes an exception.32

The Commentary to Art. 5 observes that the mere fact that a person has attended or participated in negotiations is not by itself, authority to conclude contracts which creates an agency-PE. National Courts have however adopted a restrictive approach and claimed that persons who has attended or participated in negotiations may constitute an agency-PE.33

The Commentary to Art. 5 affirms that the existence of a subsidiary company does not, of itself, constitute that company a PE of its parent company because the subsidiary company is an independent legal entity,34 but national Courts have held that a subsidiary may be considered a dependent agent by application of the same tests applied to unrelated companies.35

31 See for example: Austria, Verwaltungsgerichtshof (Supreme Administrative Court), 98/14/0026, 19 March 2002, ris.bka.gv.at/Dokument.wxe?Abfrage=Wvgh&Dokumentnummer=JWT_1998140026_20020319X00.


34 Commentary to Art. 5 § 40 and § 38.1.

35 See for example: Italy, Corte Suprema di Cassazione (Supreme Court), 7682, 25 May 2002, leggiditalia.it
II. DOMESTIC JUDICIAL TRANSPLANTS OF OECD INTERPRETIVE SOLUTIONS OR PRINCIPLES

Other examples of hybrid judicial transplants are applications of the Commentary to Art. 13 (capital gains) and Art. 24 (non-discrimination). The Commentary provides a guideline for the redemption of securities according to which differences between the selling price and the par value of the shares attributed by a shareholder to the issuing company in connection with the liquidation of such company or the reduction of its paid-up capital, may be treated in the State of which the company is a resident as a distribution of accumulated profits and not as capital gains realized by them.36 Judicial decisions however do not follow this approach and treat redemptions under the capital gains article.37

The Commentary to Art. 24 takes the position that the non-discrimination standard does not apply to payments of interest to resident/non-resident taxpayers as opposed to payments of interest to resident taxpayers because such payments are outside the scope of Art. 24 § 5,38 but national Courts bar thin cap rules that adversely ring-fence foreign lenders.39 With respect to the mutual agreement which can be reached pursuant to Art. 25 the Commentary takes the view that the obligation of implementing such an agreement is unequivocally stated in the last sentence of Art. 25 § 2 in so far as it provides that any agreement reached shall be implemented in spite of any time limits in the domestic laws of the Contracting States (hereinafter ‘CSs’),40 but national Courts have taken the position that mutual agreements are not binding on the basis of constitutional domestic constraints.41

Hybrid judicial transplants of OECD interpretive solutions or principles occur when certain areas are ‘transplant resistant’ because domestic tax cultures have developed barriers, when a potentially efficient interpretive solution is deprived of its impact because it is introduced in an incompatible setting of tax

36 Commentary to Art. 13 § 31 and Commentary to Art. 10 § 3 and § 28.
38 Commentary to Art. 24 § 79.
40 Commentary to Art. 25 § 29.1–2.
41 See for example: Germany, Bundesfinanzhof (Federal Fiscal Court), I R 111/08, 2 September 2009, Internationales Steuerrecht 2009, 814. Germany, Bundesfinanzhof (Federal Fiscal Court), I R 90/08, 2 September 2009, Internationales Steuerrecht, 2009, 817.
procedural arrangements, or when the Court expressly refers to Art. 3 § 2 of the treaties to make reference to domestic laws to determine the meaning of a treaty term or to interpret a treaty provision (see infra at para I.59). How, and to what extent, any particular OECD interpretive solution or principle imported through a judicial transplant retains its identity or is accepted, ignored, used, assimilated, adapted, rooted, resisted, rejected, interpreted, enforced selectively, and so on depends largely on local conditions.42

I.44 These types of hybrid judicial transplants are a critical area of evolution in international tax law in which the vehicle of diffusion appears to be a transplant, while the actual process of change is substantiated in the creation of domestic solutions which diverge from the original OECD interpretive solution or principle. A naïve or simplified model of judicial transplants mistakenly assumes that national judicial decisions are straightforward and direct applications of OECD interpretive solutions or principles. By contrast, in a hybrid judicial transplant of OECD interpretive solutions or principles the object of reception often does not retain its identity but is subject to significant change after the date of reception.

I.45 In conclusion hybrid judicial transplants of OECD interpretive solutions or principles show that the naïve model of judicial transplants of the Commentary is unable to account for the real processes of change, and are evidence of the fact that diffusion often involves a long drawn out process, which leads to divergence rather than to convergence. This judicial process cannot be understood without reference to events occurring prior and subsequent to such moments and challenges the assumption that there are one or more specific reception dates of a change.

C. Areas of judicial activism within gaps in the Model-Commentary integrated system

I.46 In certain cases the Commentary neither provides an interpretive solution nor adopts a principle concerning a certain issue so that there is a normative gap in the Model-Commentary integrated system. For example, the treatment of foreign PE losses is not covered by the Commentary43 and this has left room for the development of two opposed judicial national approaches: according

42 Twining, supra n 25.
43 Commentary to Artt. 23A and 23B § 44.
to the former approach foreign PE losses can be deducted in the residence-country (hereinafter the ‘RC’), but according to the latter approach they cannot. Moreover depreciation and devaluation of the PE’s assets is not treated by the Commentary, this has lead to interesting judicial decisions clarifying that capital losses are not covered by the capital gains article. Moreover, neither Art. 13 nor the Commentary settle the question of exchange gains which is entirely left to domestic laws.

The normative gap in the Model-Commentary integrated system leaves open space for the exercise of judicial activism at national level. There are essentially three instances of this activism: Courts develop frameworks for factual analysis, Courts create parameters and indicators to determine the application of a provision of the Model, and Courts rely on domestic laws to solve treaty issues.

A good example of Courts developing frameworks for factual analysis are the cases concerning the tie-break rules of Art. 4. Art. 4 § 2 a) second sentence adopts the centre of vital interests test and the Commentary observes that the State where centre of vital interests is located is the State with which the personal and economic relations of the individual are closest and provides several indicators of that. National Courts have applied consistently this tie-break rule through detailed substantial analysis of the actual conduct of life, focusing on family ties closely connected to cultural/social factors, or conducting an analysis which balances the economic and the personal ties in a kind of global view.

Good examples of indicators developed by Courts to determine the application of a treaty provision are those relating to the ‘beneficial owner’ of dividends defined in broad strokes by the Commentary to Art. 10. These indicators are found in judicial applications focused on intricate patterns (for example of private equity deals) that clarified that narrow powers to act were not in themselves sufficient for a company to be disregarded as the beneficial owner.

---

44 See infra at paras 4.115–4.125.
45 See for example: Denmark, Østre Landsret (High Court of Eastern Denmark), 14 May 2012, B-307-10, skat.dk/SKAT.aspx?oId=2046303&vId=0; France, Conseil d’État (Supreme Administrative Court), 351702, 12 June 2013, Droit Fiscal, 2013, 46, 511.
46 Commentary to Art. 13 § 16–17, to Art. 10 § 31 and § 28.
47 Commentary to Art. 4 § 14–15.
48 Canada, Tax Court of Canada, Gaudreau v. Her Majesty the Queen, 22 December 2004, 2004 TCC 840.
50 France, Conseil d’État (Supreme Administrative Court), 76,534, 19 May 1972, Droit Fiscal, 1975, 27, 116.
51 Commentary to Art. 10 § 12.4 and § 12.6.
INTRODUCTION

owner of the dividends. With respect to the ‘restricted force of attraction of PE’ to determine in which case interest is not attracted and therefore subject to isolated treaty treatment Courts have established a counter-factual argument: interest was not attributable to a fixed base in Switzerland of a taxpayer resident of Germany (and so was taxable in Germany i.e. the RC of the recipient) because the interest could have been realized in the RC irrespectively from the fixed base. Another Court attributed relevance to involvement of the PE in the decision process leading to the payment of interest.

Finally, a good example of judicial activism within gaps in the Model-Commentary integrated system is the reliance by Courts on domestic laws to solve treaty issues about the application of FTC rules. In a similar manner the application of Art. 6 on income from immovable property is based on domestic laws of the CSs in particular with respect to how the income from immovable property is actually taxed. Domestic laws are also applied to determine the amount of taxable income from immovable property which is assessed as ‘notional income’.

III. DOMESTIC JUDICIAL TRANSPLANTS AND INTERPRETIVE TECHNIQUES OF TAX TREATIES

This book shows that OECD interpretive solutions or principles are implemented through domestic judicial transplants which lead to judicial convergence or divergence and this proves that the Commentary is effectively used by national judges. The next question is how and to what extent national judges rely on the Commentary when they interpret tax treaties.

Interpretation of treaties, including tax treaties, is governed by Artt. 31–33 of the Vienna Convention on the Law of Treaties (hereinafter the ‘VCLT’)

52 See for example: Denmark, Østre Landsret (High Court of Eastern Denmark), B-2152–10, 20 December 2011, skat.Denmark/SKAT.aspx?id=2035604; Denmark, Landskatteretten (National Tax Tribunal), 09–01478, 3 March 2010, skat.Denmark/skat.aspx?id=1896443&oldid=0.
53 Germany, Finanzgericht Bayern (Tax Court Bayern), 9 K 3576/01, 10 December 2003, Entscheidungen der Finanzgerichte, 2004, 634.
55 See for example: Austria, Verwaltungsgerichtshof (Supreme Administrative Court), 2000/14/0172, 28 September 2004, ns.bka.gv.at/JudikaturEntscheidung.wxe?Abfrage=Vwgh&Dokumentnummer=JWR_2000140172_20040928X02.
56 Commentary to Art. 6 § 4–3.
which advance two basic types of interpretation (strict interpretation and purposive interpretation), but Art. 3 § 2 of the Model is also relevant in this matter.\footnote{Art. 3 § 2 of the Model Treaty provides that: As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.} First, Art. 3 § 2 points at ‘any term not defined in the treaty’ and clarifies that these terms have the meaning that they have under the law of that State ‘for the purposes of the taxes to which the Convention applies’, and this is the so-called ‘renvoi’ method. Second, Art. 3 § 2 points at ‘terms that are defined in the treaty’, and for which the context does not require another interpretation, leading to the so-called autonomous interpretation. Third, Art. 3 § 2 points at ‘terms that are defined in the treaty, but for which the context requires another interpretation’, setting the stage for the so-called contextual interpretation.

The analysis of interpretation of tax treaties is thus developed here by describing how the two basic types of interpretation of tax treaties advanced by Artt. 31–33 of the VCLT (that is strict interpretation and purposive interpretation) operate in combination with three approaches of interpretation of tax treaties advanced by Art. 3 § 2 of the Model (the ‘renvoi’ method, autonomous interpretation, and contextual interpretation).

A. Strict and purposive interpretation

Strict interpretation is generally the first step in adjudicating tax treaty cases, an approach that conforms to Art. 31 § 1 of the VCLT, which stipulates that a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.\footnote{See for example: Australia, Federal Court of Australia, \textit{Medermott Industries v. Commissioner of Taxation of The Commonwealth of Australia}, 29 April 2005, [2005] FCAFC 67; Belgium, Hof van Beroep Antwerpen (Court of Appeal, Antwerpen), 1982–07–29, 29 June 1982, \textit{Fiscale Jurisprudentie}, 1983, 2, 20, 35; Australia, Federal Court of Australia – Full Court, \textit{Lamesa Holdings BV v. Commissioner of Taxation}, 20 August 1997, [1997] FCA 785; Canada, Tax Court of Canada, \textit{Thomas F. Cheek v. Her Majesty the Queen}, 31 January 2002, [2002] 2 C.T.C. 2115.} By contrast, purposive interpretation relies on the intention of the parties and the purpose/scope of the treaty to address crucial issues that cannot be solved by relying on just the text of the treaties. There is a dynamic tension between strict interpretation and purposive interpretation. When the strict approach does not solve issues, rules are interpreted under purposive interpretation treaty on the basis of the intention of the parties and the purpose/scope of the treaty and extra-textual elements are used, in
accordance with the broader approach advocated by Art. 31 §§ 2 and 3£ and 32 VCLT.

I.55 For example, the concept of ‘liable to tax’ under Art. 4 of the Model is semantically open to diverging interpretations: it may include a situation in which the RC does not in fact impose tax but the taxpayer is simply ‘subject to tax’ under the domestic laws of a CS, or it may include a situation in which the income is effectively taxed. In a case decided in Luxembourg the Court used purposive interpretation to solve this problem and held that Luxembourg companies fell within the scope of the treaty although they did not pay any tax in Luxembourg because the term ‘liable to tax’ merely involves a requirement of formally being subject to unlimited tax liability actually paying the tax. The Court referred to Artt. 31–33 of the VCLT by ascertaining the common intention of the CSs and determined that the residence article of the treaty had to be applied in the light of its object and purpose. The Court found that the objective of the treaty to avoid double taxation did not preclude granting treaty benefits to persons exempt from taxation in one of the CSs.

I.56 The Court reasoned that the treaty allocates taxing rights between the CSs, so that the fact that a CS chooses not to use the taxing rights allocated to it by the treaty does not, in itself, attribute to the other CS the power to tax the relevant income. If the other CS indeed exercised its taxing rights in such a case, there was a potential risk of double taxation in the future if the former State reconsidered its position.

60 Art. 31, provides:

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

(2) The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes;

(a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

(b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

(3) There shall be taken into account, together with the context:

(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(c) any relevant rules of international law applicable in the relations between the parties.

61 Art. 32 (titled ‘Supplementary means of interpretation’) provides that recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion in order to confirm the meaning resulting from the application of Art 31, or to determine the meaning when the interpretation according to Art 31 (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable.
III. DOMESTIC JUDICIAL TRANSPLANTS AND INTERPRETIVE TECHNIQUES OF TAX TREATIES

Another Court observed that treaties apply the principle that tax exemption in one CS is not made conditional upon the fact that the income is actually taxed in the other CS, because it is enough that a person’s connection to the State in question could potentially result in unlimited tax liability in order to be considered a resident.62

Purposive interpretation has been also used to address the problem of retroactivity of domestic exit taxes levied on the transfer of residence. In a Dutch case the question was whether a tax on the increase in the value of the shares upon the shareholders’ emigration was allowed by the provisions on capital gains in the treaties between the Netherlands and the UK, Belgium and the US, respectively. The position of the Court was that the treaties did not breach the required good faith and did not prevent the Netherlands exit tax from being levied for three reasons: first, on the basis of the Commentary the reference to ‘gains’ in Art. 13 § 4 of the Model does not preclude a CS from deeming as taxable income capital appreciation that is not realized by alienation; second, the taxable gains under Netherlands domestic laws were deemed to have been derived before his emigration at a time when no treaty was applicable; and third, the exit tax covered the increase in the value of the shares during the period in which the Netherlands was the RC of the taxpayer.63

B. The renvoi method

According to the first method mandated by Art. 3 § 2 – the renvoi method – the ‘terms not defined in the treaty’ have the meaning that they have at that time under the tax laws of domestic tax systems for the purposes of the taxes to which the Convention applies.64 Before the renvoi method can be applied, it must be determined whether the term is defined not only in the basic treaty but also in the treaty’s ‘co-text’ (Art. 31 § 2) that is the normative textual

---

64 Paragraph 13.1 of the OECD Commentary to Art. 3 allows reference to domestic tax and non-tax laws, and clarifies that for the purposes of art. 3 § 2, the meaning of any term not defined in the Convention may be ascertained by reference to the meaning it has for the purpose of any relevant provision of the domestic law of a Contracting State, whether or not a tax law. Paragraph 13.1 of the OECD Commentary also clarifies that, where a term is defined differently for the purposes of different laws of a Contracting State, the meaning given to that term for purposes of the laws imposing the taxes to which the Convention applies shall prevail over all others, including those given for the purposes of other tax laws, as well as that States that are able to enter into MAPs (under Art. 25 and, in particular, § 3 thereof) that establish the meanings of terms not defined in the Convention should take those agreements into account in interpreting those terms.
elements directly linked to the treaty text. This co-text comprises the text of the treaty itself together with the preamble, as well as protocols made between all the parties in connection with the conclusion of the treaty and any instruments made in connection with the conclusion of the treaty, such as explicative notes made by one or more parties and accepted by the other parties as an instrument related to the treaty.

I.60 For example, the Commentary realistically assumes that in light of the great differences between the laws of OECD Member Countries it is impossible to work out an autonomous definition of dividends that would be independent of domestic laws and thus acknowledges that it is open to Cs, to make allowance for peculiarities of their laws.65 This approach has lead to the acceptance of the principle that characterization of dividends is based on domestic laws of the SC. In the Memec case decided in the UK for example the Court held that the absence of a specific definition of dividends in the treaty implied that the term ‘dividends’ used by such an article was interpreted as having the meaning indicated by the treaty interpretation clause equivalent to Art. 3 § 2 of the Model. So any term not relevantly defined by the treaty – such as dividends – must by defined in the light of the domestic laws of the CS.66 A Dutch case concerning the so-called ‘equivalent wage’ applied Dutch domestic laws to define this concept, according to which the salary of an employee owning a substantial interest in the company in which he was employed had to be equal to at least 70 per cent of the salary which is customary for similar employment.67

I.61 Following a legalistic approach in the interpretation of tax rules, the *renvoi* method is generally employed in combination with strict interpretation. A potential outcome of the *renvoi* method is however that each of the parties to a treaty applying its domestic definition of terms may adopt incompatible meanings leading to differences in interpretation or conflicts of qualification that may determine double taxation or double non-taxation.68 It may be

---

65 Commentary to Art. 10 § 23.
III. DOMESTIC JUDICIAL TRANSPLANTS AND INTERPRETIVE TECHNIQUES OF TAX TREATIES

possible to resolve the inconsistent interpretations using the mutual agreement procedure under Art. 25 of the Model (hereinafter ‘MAP’). In such a situation of bilateral settlement the *renvoi* method can be employed in combination with purposive interpretation.

C. Autonomous interpretation

The ‘autonomous interpretation’ method set out in Art. 3 § 2 applies to terms that are defined in the treaty itself and which do not require interpretation that is based on non-treaty sources. National judges have used autonomous interpretation to terms used in self-executing treaty rules that can be applied without referring to the domestic laws of the CSs.

Essentially the feature of autonomous interpretation is that interpretive activity is carried out entirely *within* the treaty system and covers terms and concepts that are sufficiently defined by the treaties, as occurs, for example, in cases involving permanent establishments (Art. 5), interest (Art. 11 § 3), exemption or foreign tax credit for foreign-source income (Artt. 23A and 23B), and non discrimination (Art. 24). With regard to interest the Commentary observes that the definition of this type of income in the first sentence of Art. 11 § 3 is exhaustive and that it is preferable not to include a subsidiary reference to domestic laws – which should as far as possible be avoided – in the text in so far as the definition covers all the kinds of income which is regarded as interest in the various domestic laws and ensures that treaties are unaffected by future changes in any country’s domestic laws.

The first step of autonomous interpretation is the strict or literal interpretation of the treaty terms following the treaty definitions, but often Courts refer to the elements indicated by Artt. 31 and 32 VCLT, which may include the Commentary only if certain requirements are met (see *infra* at paras I.76–I.88). So autonomous interpretation have sometimes been mixed with purposive interpretation, by pointing, for example, at the intentions of the CSs.  

D. Contextual interpretation

Contextual interpretation is based on Art. 3 § 2, which refers to ‘terms that are defined in the treaty, but for which the context requires another

---

69 This is in line with Art. 31 (4) of the VCLT, which provides that a special meaning shall be given to a term if it is established that that was what the parties intended.
interpretation’. Contextual interpretation has created two major problems. The first problem is identifying the elements of the ‘context’ that can be used if due respect is to be given to the VCLT. The second problem lies in determining the exact role of the Commentary in such contextual interpretation. The former problem is discussed in this section, while the later problem will be addressed infra at paras I.76–I.88.

I.66 The review of current judicial approaches and best practices reveals that the ‘context’ in contextual interpretation has the broadest meaning and includes essentially all the elements beyond the mere text, as listed by Artt. 31 § 3 and 32 § 1 of VCLT. These elements are grouped here under two headings: ‘strict context’, as defined by Article 31 § 3, and ‘broad context’ as defined by Article 32 § 1. Strict context’ and ‘broad context’ constitutes the ‘VCLT context’.

I.67 The ‘strict context’ (Article 31 § 3, VCLT) includes any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; i.e., agreements resulting from MAPs, as well as any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation that can be drawn from such MAPs. It also includes any relevant rules of international law applicable in the relations between the parties.

I.68 The ‘broad context’ (Art. 32 § 1, VCLT) includes supplementary means of interpretation, such as the preparatory work for the treaty including the minutes of the meetings of the tax delegations, as well as the circumstances of conclusion of the treaty.

I.69 Contextual interpretation is generally combined with purposive interpretation because it looks at the ‘VCLT context’ which goes beyond the mere text of the treaty, so there is generally limited room for strict interpretation when recourse is made to contextual interpretation. Moreover the ‘VCLT context’ may include the Commentary (which does not fall into any of the categories enumerated by Artt. 31 § 3 and 32 § 1 of VCLT) only if certain requirements are met (see infra at paras I.76–I.88).

E. Ambulatory vs static interpretation

I.70 Another interpretation issue is whether terms are to be interpreted using an ambulatory or static interpretation approach. Under the static interpretation,
the ordinary meaning of a rule of treaty is attributed when the treaty is concluded. By contrast, the ambulatory interpretation approach adopts the current meaning of terms used in the treaty.\textsuperscript{70}

The main argument in favour of static interpretation is that the CSs are bound by the original provisions of the Treaty on the basis of the principle \textit{pacta sunt servanda}, so that the stability of the meaning of treaty rules prevents any \textit{de facto} modifications of the treaty.\textsuperscript{71}

An example of static interpretation can be found with regard to Art. 21 which relieves the SC from any limitations to its treaty taxing power imposed by Art. 21 § 1 (which attributes exclusive taxation to the RC). National Courts have generally construed Art. 21 § 1 as an authorized derogation by the business profits article to the other income article in cases involving participations of active partners in small companies. For example, in a Belgian case the Court held that the remuneration of active partners was subject to Belgian laws, arguing that under Art. 3 § 2 of the treaty the remuneration of a working partner was characterized as ‘business profits’ under Belgian laws adopting static interpretation of the treaty.\textsuperscript{72}

Another example of static interpretation is found in a case decided in Portugal. At a certain point in time Portugal had made observations on different versions of the Commentary under which it reserved its right to treat and tax as ‘royalties’ software income if: (i) less than the full rights to software were transferred; (ii) such rights related to software acquired for the business use of the purchaser; and (iii) the software was adapted to the purchaser and not standardized. A Belgium company transferred to a company resident of Portugal only partial rights to software, which could be used by the taxpayer only for its own internal business. The Court held that the software payments to the Belgian company were business profits under the relevant treaty article.


\textsuperscript{71} See for example: Belgium, Hof van Cassatie/Cour de Cassation (Supreme Court), F1851N, 21 December 1990, De Fiscale Koerier, 1991, 6, 210 (on active partner income); Portugal, Supremo Tribunal Administrativo (Supreme Administrative Court), 0621/09, 2 February 2011, dgsi.pt/jsta.nsf/35fbbbf22e1bb1e680256f8e003ea91d2d7c6b6a929a922e80257833003721a5OpenDocument (on royalties); It has been pointed out that ambulatory interpretation would be practically attributable to an international body, the OECD Fiscal Committee, the power to indirectly change a convention already ratified by the national parliaments and turned into a national law. See, Stefano Guglielmi, ‘Il caso Philip Morris nelle recenti modifiche al Commentario OCSE’, (2006) Fiscalità Internazionale 149-57.

\textsuperscript{72} Belgium, Cour de Cassation (Supreme Court), F1851N, 21 December 1990, De Fiscale Koerier, 1991, 6, 210.
despite the fact that this observation was included in the Commentary after the conclusion of the treaty applicable in the case at hand (static interpretation).\textsuperscript{73}

\textbf{I.74} By contrast, there are several arguments in favour of ambulatory interpretation. First, when CSs adapt the original provisions through interpretation there is no need of specific treaty procedures. Second, a flexible approach to the meaning of the treaty provisions allows a \textit{de facto} modification of the treaty that is consistent with economic and legal developments, an adjustment process that preserve on-going contractual relations.\textsuperscript{74}

\textbf{I.75} Static interpretation is generally employed in combination with strict interpretation, while ambulatory interpretation is generally employed in combination with purposive interpretation (employed in autonomous or contextual interpretation). The rule of thumb is that if static interpretation fails, ambulatory interpretation is to be used.\textsuperscript{75} However if the ambulatory interpretation adopted by a CS is not accepted also by the other CS, recourse to the MAP is needed. In this situation each CS might view the other CS as having made a \textit{de facto} violation of the treaty through unilateral interpretation potentially leading to termination of the treaty, unless the Competent Authorities adopt a mutually agreed interpretation.

\section*{IV. THE USE OF COMMENTARY IN THE APPLICATION OF TAX TREATIES}

\textbf{I.76} To recapitulate: Artt. 31 and 32 of the VCLT refer to essentially three types of contextual elements in the interpretation of tax treaties:

1) the ‘\textit{co-text}’ which includes:
   - the preamble + text + annexes of the treaty,
   - any agreement relating to the treaty,
   - any instrument in connection with the conclusion of the treaty;

2) the ‘\textit{strict context}’ which includes:
   - any subsequent agreement,
   - any subsequent practice,
   - any relevant rules of international law;

\textsuperscript{73} Portugal, Supremo Tribunal Administrativo (Supreme Administrative Court), 0621/09, 2 February 2011, dgsi.pt/jsta.nsf/35ffbbf22e1be6e60256fe803ea9511/d2defb6aa0b9a22e80257833003721a5?OpenDocument.

\textsuperscript{74} See for example: Canada, Tax Court of Canada, \textit{Prévost Car Inc. v. Her Majesty the Queen}, 22 April 2008, 2008 TCC 231.

\textsuperscript{75} Art. 3 § 2 of Model modified in 1995 adopted ambulatory interpretation.
3) the ‘broad context’ (i.e. supplementary means of interpretation) which includes:
- preparatory work of the treaty,
- circumstances of conclusion of the treaty.

In conclusion, Artt. 31 and 32 of the VCLT constitute the basis for an integrated approach to interpretation of tax treaties, in which strict interpretation comes first and looks at the textual elements, while purposive interpretation looks at a broad context (i.e. supplementary means of interpretation) when strict interpretation would yield a result inconsistent with the purpose of the treaty. Essentially strict interpretation looks not only at the text of the rule to be interpreted, but also at the 'co-text'. Literal interpretation also extends to the 'strict context'. Purposive interpretation looks the broad context of interpretation when literal interpretation fails (see infra Figure I.1).

As mentioned above, a problem in the interpretation of tax treaties is determining the exact role of the Commentary, that is whether it should be included within the 'co-text', the 'strict context', or the 'broad context'. This problem of the 'use' of the Commentary is widely debated. The solution...
proposed here is that an interpretive solution or a principle established by the Commentary are binding for the national judge only if certain conditions are satisfied.81

The Commentary as such clearly does not constitute a part of the co-text because it is neither the preamble of a treaty, nor an annex of a treaty, nor any agreement relating to the treaty, nor an instrument in connection with the conclusion of a treaty. Likewise the Commentary as such does not constitute a part of the strict context because it is neither a subsequent agreement, nor a subsequent practice, nor amounts to a source of international law. For example, in a Czech transfer pricing case concerning a 'special relationship' concept the Court held that the approach of the tax authorities, which relied solely on the Commentary, was contrary to treaty interpretation rules of the VCLT, noting that the Commentary is not part of the context of these treaties within the meaning of the VCLT because it is not a 'subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions', nor a 'subsequent practice' in the application of the treaty.82

Finally the Commentary as such does not constitute a part of the broad context because it is neither a preparatory work of a specific treaty, nor can it be considered a circumstance of conclusion of a specific treaty, in spite of the fact that the CSs may have in practice relied on the Model in the actual negotiation of the treaty.83

In certain situations however the Commentary may be deemed to constitute one of the elements of the co-text, strict context or broad context as defined by the VCLT and in those situations the interpretive solution or principle provided by the Commentary can be deemed by the national judge to be binding.


83 See for example: Canada, Tax Court of Canada, Knights of Columbus v. Her Majesty the Queen, 16 May 2008, 2008 TCC 307.
IV. THE USE OF COMMENTARY IN THE APPLICATION OF TAX TREATIES

In certain cases the Commentary is binding because it falls under the co-text (Art. 31 § 2, VCLT). A situation in which this occurs is when both CSs expressly refer in the treaty or annexed documents to the interpretive solution or principle of the Commentary as binding. For instance, the protocol of the treaty between Mexico and Italy, provides that ‘with reference to Art. 7 § 4 mentioned before, the CSs shall apply the provisions contained therein in accordance with their domestic laws and in the sense given to such paragraph in the Commentaries of the 1977 Model Convention drawn up by the OECD Committee on Fiscal Affairs’. 84

Another situation in which the Commentary is binding because it falls under the co-text is when two OECD CSs have concluded a treaty with a text equal to the Model and both CSs have expressly accepted the OECD interpretive solution or principle (or the Commentary as a whole).

In other cases the Commentary is binding because it falls under the strict context (Art. 31 § 3, VCLT). A situation in which this occurs is when the interpretive solution or principle established by the Commentary is evidence of international customary law or country practices that are accepted by both CSs, (Art. 31 § 3, c), VCLT. For example, in a German case the Court held that the practice of the two CSs could be taken into account in accordance with the VCLT, although not beyond the clear wording of the treaty. 85

Finally, in certain cases the Commentary is binding because it falls under the broad context, i.e. supplementary means of interpretation (Art. 32 § 1, VCLT), for example, when there is documentary proof that the Commentary has been effectively used in the negotiation process in relation to the issue at stake. A final case in which the Commentary is binding is when a term is not defined at all by the domestic laws of both CSs but is unequivocally defined by the Commentary.

The interplay between the VCLT two basic types of interpretation (strict interpretation and purposive interpretation), the three modes of interpretation

84 For instance, the Protocol of the treaty between Mexico and Italy, provides that ‘with reference to para 4 of Art. 7 mentioned before, the Contracting States shall apply the provisions contained therein in accordance with their domestic laws and in the sense given to such paragraph in the Commentaries of the 1977 Model Convention drawn up by the OECD Committee on Fiscal Affairs’.

implied by Art. 3 § 2 of the Model (renvoi method, autonomous interpretation, contextual interpretation), and the cases in which the Commentary is binding can be represented in Figure I.1.

<table>
<thead>
<tr>
<th>Co-text (Art. 31 § 2, VCLT)</th>
<th>Strict context (Art. 31 § 3, VCLT)</th>
<th>Broad context (Art. 32 § 1, VCLT)</th>
</tr>
</thead>
<tbody>
<tr>
<td>preamble + text + annexes of the treaty</td>
<td>subsequent agreement</td>
<td>preparatory work of the treaty</td>
</tr>
<tr>
<td>agreement relating to the treaty</td>
<td>subsequent practice</td>
<td>circumstances of conclusion of the treaty</td>
</tr>
<tr>
<td>instrument in connection with the conclusion of the treaty</td>
<td>relevant rules of international law</td>
<td></td>
</tr>
</tbody>
</table>

**Notes:**

- The Commentary is binding when it falls under the co-text (Art. 31 § 2, VCLT): 1) both CSs expressly refer in the treaty or annexed documents to the interpretive solution or principle of the Commentary as binding; 2) two OECD CSs have concluded a treaty with a text equal to the Model and both CSs have expressly accepted the OECD interpretive solution or principle.
- The Commentary is binding when it falls under the strict context (Art. 31 § 3, VCLT): or when the interpretive solution or principle established by the Commentary is evidence of international customary law or country practices that are accepted by both CSs, (Art. 31 § 3, c).
- The Commentary is binding when it falls under the broad context (Art. 32 § 1, VCLT): i.e. there is proof that the Commentary has been effectively used in the negotiation process in relation to the issue at stake.
- When strict interpretation combined with the renvoi method leads to unilateral conflicting interpretations, then purposive interpretation may be pursued.
- Autonomous interpretation can be pursued through purposive interpretation when the use of the Commentary is allowed and is binding.

**Figure I.1** VCLT types of interpretation (strict interpretation and purposive interpretation), Art. 3 § 2 modes of interpretation (renvoi, autonomous interpretation, contextual interpretation), and cases in which the Commentary is binding

In conclusion a domestic Court must consider the interpretive solution or principle provided by Commentary to be binding only when, in a specific circumstance, the Commentary constitutes one of the elements of the co-text, strict context or broad context as defined by the VCLT. Domestic courts however have often taken a different position because they attributed to the
Commentary a broad and vague ‘interpretive authority’, as if it were a kind of supra-national binding regulation, i.e. a prescriptive document. The practical result in these cases is that domestic Courts have created new interpretative positions using the Commentary as authority. These positions often actually diverge from those advanced by the Commentary.

When judges develop this reasoning they essentially carry out a hybrid judicial transplant and justify a local solution on the basis of the ‘OECD authority’. The Philip Morris case86 decided in Italy is a good example of this approach. The issue was whether the Italian company, forming part of a multinational group, could constitute a PE of other companies belonging to the same group under Art. 5 of the Germany–Italy tax treaty. The Cassazione developed its analysis on the basis of a substance-over-form approach and held that an Italian company can be a ‘multiple permanent establishment’ of foreign companies of the same group. In particular, according to the Cassazione, the participation of employees of a resident company in the conclusion of a contract between a foreign company and another resident entity falls within the concept of ‘authority to conclude contracts’ allegedly according to Art. 5 § 5 of the OECD Model, while such a position was not present in the Commentary itself.87

BIBLIOGRAPHY

Tax treaties in general

Baker, Philip, Double Taxation Conventions (Sweet & Maxwell 2010).

INTRODUCTION

Shonfeld, Jeans and Xaver Ditz (eds), *Doppelbesteuerungsabkommen DBA- Kommentar* (Schmidt 2013).
Vogel, Klaus and Moris Lehner (ed.), *Doppelbesteuerungsabkommen* (Seiten 2008).

The OECD Model

Lang, Michael, et al. (eds), *The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties* (Cambridge University Press 2012).
Serano, Fernando, *La Modificacion del Modelo de Convenio de la OCDE para Evitar la Doble Imposicion Internacional y Prevenir la Evasion Fiscal* (Universidad Complutense de Madrid 2002).

Interpretation of tax treaties

BIBLIOGRAPHY


Schilcher, Michael and Patrick Weninger (eds), *Conflicts of Qualification in Tax Treaty Interpretation* (Linde 2008).


The OECD Commentary


Ecker, Thomas and Gernot Ressler (eds), *History of Tax Treaties. The Relevance of the OECD Documents for the Interpretation of Tax Treaties* (Linde 2011).


Ward, David, ‘Is there an Obligation in International Law of OECD Member States to Follow the Commentaries on the Model?’ in: Sjoerd Douma and Frank Engelen (eds), *The Legal Status of the OECD Commentaries* (IBFD 2008).
