

COMPARATIVE APPROACHES TO THE INTERPRETATION OF DOUBLE TAX CONVENTIONS

ABSTRACT

The primary object of double tax conventions is to reduce the incidence of double taxation and to facilitate greater cooperation between member states in the management of tax avoidance and evasion. Double tax conventions are often expressed in general terms and seek to capture the diversity and complexity of two disparate systems of law. Traditionally, such conventions take a long time to negotiate, ratify and incorporate into domestic law. For these reasons, the construction and application of double tax conventions is all the more significant and it is necessary that the approaches adopted to that end do not frustrate these objects.

I INTRODUCTION

Double tax conventions are international mechanisms by which sovereign states assume reciprocal obligations with respect to the application of their taxation laws to commercial dealings between their respective nationals and/or residents. Such treaties are more commonly bilateral but at times may be multi-lateral as in the case of the Nordic Treaty.¹

The relative merits of bilateral and multi-lateral treaties are certainly a matter that warrants further consideration,² but for the purposes of this paper it is sufficient to note that the Nordic Treaty is supplemented by a lengthy protocol dealing with a range of bilateral issues and problems. In effect, the Nordic Treaty may be regarded as a hybrid international arrangement that consists of a series of bilateral treaties held together by common articles or principles.

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¹ *Convention Between the Nordic Countries for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital*, September 23, 1996. The treaty applies to Denmark, Faroes, Finland, Iceland, Norway and Sweden. It follows closely the OECD Model Convention. Further, Austria has proposed a multi-lateral treaty for the European Union. Note that there is no principle of international law or custom that encourages or otherwise the making of treaties on one basis or another (bilateral or multi-lateral).

² For a comprehensive examination of the issues raised by multi-lateral treaties, see Michael Lang, et al, 'Multilateral Tax Treaties: New Developments in International Tax Law', *Series on International Taxation: 18* (1998). Richard J Vann, 'A Model Tax Treaty for the Asian-Pacific Region?' (1991) 45 *Bulletin for International Fiscal Documentation* 99, 151-63.

In contrast, whilst the OECD Model³ commands wide international acceptance, many countries have expressed reservations as to the meaning and operation of certain articles. It is noteworthy that the model is nothing more than that — a model. It is not a binding agreement on any OECD member state. A proposal to convert the model into a binding multilateral agreement would necessarily involve very lengthy qualifications and reservations to cater for the peculiarities of dealings between countries.⁴ This assumes that a large number of countries can reach agreement, which is a highly unlikely if not an impossible task given the diversity of nations and the political considerations that govern the ultimate shape and terms of the treaty.⁵

However, the OECD Model has been widely regarded as a template that contains a common set of principles that have formed and that continue to form the basis of bilateral treaties between both member and non-member countries. Its terms have often been adopted with minor modifications and, in that respect the model has come, by default, to have some of the effects of a multi-lateral treaty. In effect the OECD Model Treaty

has become the standard reference to which treaties between developed countries are negotiated. Although bilateral treaties sometimes adopt individual provisions which vary from those set forth in the OECD Model, these variations are relatively minor when compared to the very large number of instances in which provisions are patterned after the OECD text. The OECD Model Treaty therefore has come to have a special significance. Although it technically is not binding on any country, it has almost acquired the status of a multi-lateral instrument.⁶

³ *Model Tax Convention on Income and on Capital, Organization for Economic Co-operation and Development*, 1992. The OECD Model is a descendent of the London Model concluded in 1946. The current UN Model Tax Convention is an alternative model that adopts similar principles to the OECD Model. The UN Model is a descendent of the Mexico Model Convention concluded in 1943.

⁴ On this point Burns indicated that ‘given the diversity of tax laws, purely textual multi-lateralism is likely to achieve little more than what currently is achieved through the bilateral tax treaty network. It faces the same problems ... as those faced by harmonisation’: Lee Burns, ‘Article Commentary’ (1999-2000) 53 *Tax Law Review* 39, 45–6. These comments were made in agreement with the views in John F Avery-Jones, ‘The David R. Tillinghast Lecture – Are Tax Treaties Necessary?’ (1999-2000) 53 *Tax Law Review* 1.

⁵ Bilateral treaties often take many years to negotiate and conclude. Assuming that it is within the realm of the possible, one can only wonder how long it would take to negotiate a multi-lateral treaty between a large number of countries such as members of the OECD.

⁶ American Law Institute, *Federal Income Tax Project, International aspects of United States Income Taxation II: Proposals on United States Income Tax Treaties* (1992) 3.

The gradual harmonisation of treaty terms and principles promotes greater certainty in cross border commercial dealings, which could translate into net global efficiency gains. However, this advantage is outweighed, to some extent, by the inevitable consequence that the great number of bilateral treaties and the time it takes to negotiate or re-negotiate such treaties may inhibit the implementation of new national policies that relate to cross border dealings, and/or inhibit changes to internal laws.⁷ This may encourage unilateral action by member states such as the enactment of laws to override or neutralise the effect of the relevant treaty.

Other powerful forces that further promote treaty harmonisation include the development of relatively detailed commentaries on the OECD Model, of the principles contained in the Vienna Convention and their application by national courts to the interpretation and application of double tax conventions.⁸ The gradual convergence of the principles and approaches to treaty interpretation has arguably made a greater contribution to the alleviation of double taxation than the traditional credit/exemption mechanism adopted in double tax conventions.

As a general rule, absent a double tax agreement, sovereign states have an unlimited jurisdiction to impose taxation upon persons that engage in transactions that have a connection or nexus with their territory. Subject to the requirement of a territorial nexus between the subject of taxation and the relevant territory, general international law does not preclude double taxation.⁹ Further, there is no international obligation on any nation to have regard to the taxation laws of other states in the design and development of its domestic laws. In the discharge of their judicial function, domestic courts enforce the relevant domestic taxation legislation irrespective of its impact on foreign persons or non-residents. Hence conventional wisdom suggests that the primary mechanism by which states can alleviate the potential for double taxation is through the treaty framework.

Double taxation has, however, a number of recognised negative consequences including the inequitable distribution of tax revenues between nations and potentially harmful impact on international trade and the free flow of investment between nations. Concern about the harmful impact of double taxation may be traced back to a 1923 report on the subject prepared for a committee of the League

⁷ J F Avery-Jones, above n 4, 4.

⁸ *Vienna Convention on the Law of Treaties*, opened for signature 23 May 1969, 1155 UNTS 331, (entered into force 27 January 1980). Whilst many countries have signed the convention, many have not ratified it. Australia, Canada, Japan, and the United Kingdom are among the few that have ratified it.

⁹ For an examination of the notion of jurisdiction and a range of related issues, see Stef Van Weeghel, 'The Improper Use of Tax Treaties, With Particular Reference to the Netherlands and the United States', *Series on International Taxation: 19* (1998) 10.

of Nations.¹⁰ At that time, Europe relied primarily on *impot reals* (impersonal taxes) as the primary source of taxation rather than income tax as we now know it.¹¹ *Impot reals* were essentially a series of separate source-based taxes. On or about that time, many countries began to adopt income taxes in the form known today (personal taxes).

The gradual integration of the global economy has created many challenges and opportunities for business and investment. Global integration or globalisation has opened up new markets and encouraged greater international co-operation that has resulted in reduced barriers to trade in goods and services. In a more integrated world multi-national enterprises developed a more ‘global’ view of their businesses and investments. The presence of double tax conventions has created a sound framework for the free flow of capital and commercial dealings and in part encouraged states to widen their treaty network so as to avoid unnecessary barriers to free commercial dealings.

International juridical (as opposed to economic) double taxation arises from the imposition of comparable taxes in two states on the same taxpayer in respect of the same subject matter and for the same period.¹² As a general rule, the country of residence exercises its ‘domiciliary jurisdiction’ to tax its residents on worldwide income whereas the country of source exercises its ‘source jurisdiction’ to tax income or profits sourced within its territory. It is therefore conceivable that two independent states may regard a particular entity as a resident of their territory (residence-residence conflict) or treat the same income as sourced in their territory (source-source conflict). Alternatively, there would be double taxation where the same income is taxed at source and in the residence jurisdiction without relief (residence-source conflicts).¹³ The overlap of jurisdictions could result in double taxation of the same income to the same taxpayer. In this sense it must be distinguished from economic double taxation where the same item of income is

¹⁰ Report on Double Taxation Submitted to the Financial Committee, League of Nations Doc.EFS73F19 (1923). Reprinted in *4 Staff of Joint Committee on Taxation, Legislative History of the United States Tax Conventions 4049* (1962).

¹¹ An *impot real* refers to a series of separate taxes imposed on different types of income on source basis such as immovable property, industrial and commercial establishments, mortgages, directors fees, earned income, transferable securities and various credits and annuities: J F Avery-Jones, above n 4, 12–3.

¹² *Commentary on the Model Tax Convention on Income and on Capital*, OECD 2002, 7. See also Klaus Vogel et al, *Double Taxation Conventions*, (3rd ed, 1997) 9.

¹³ For an examination of the jurisdictional conflicts and the causes of double taxation see Richard Doernberg & Luc Hinnekens, *Electronic Commerce and International Taxation* (2001), p 17; American Law Institute, *Federal Income Tax Project, International aspects of United States Income Taxation II: Proposals on United States Income Tax Treaties*, (1992), 5.

taxed in two or more states during the same period to different taxpayers as in the case of the separate taxation of corporations and their beneficiary shareholders.

Double taxation can also arise from differences or inconsistencies in the characterisation of transactions and/or application of legal principles to particular arrangements. Double tax conventions operate to alleviate double taxation by providing an agreed set of principles and tie-breaker rules that govern and determine the circumstances in which and the extent to which the country of source may impose taxation on income sourced within its territory.¹⁴ In addition, double tax conventions normally require the country of residence to provide relief for source taxation in the form of a foreign tax credit or a complete exemption from taxation of profits generated in the other (source) contracting state.¹⁵

It is often stated as an absolute proposition that double tax conventions must be interpreted in such a manner as to eliminate double taxation. This proposition is consistent with the traditional conception of the primary function of double tax conventions. However, it is critical to remember that double tax conventions provide an agreed framework for the reciprocal qualification or limitation of the domestic jurisdiction to impose taxation. In effect each contracting state agrees to eliminate double taxation only within the framework of the convention and to the extent that the terms of the convention demand. Therefore there is merit in the proposition that parties to double tax conventions should be presumed to have agreed to compromise their sovereignty only to the extent that it is unequivocally clear from the terms or text of the treaty.

The purpose of this paper is to examine and evaluate the principles and approaches adopted in a number of jurisdictions to the interpretation of double tax conventions and to identify the forces that encouraged the gradual convergence of such principles and approaches and the development of common themes.

This paper posits that despite the apparent diversity in the design of taxation systems in both civil and common law jurisdictions, in general the actual approaches adopted are conceptually comparable and that substantive differences are limited and often are a matter of impression and degree. In the long term, the gradual economic and social integration of nations could prove to be a powerful force towards greater harmonisation of taxation systems and uniformity in approach to the interpretation and application of double tax conventions.

¹⁴ For example, double tax conventions may require the country of source not to tax business profits generated within its territory otherwise than through a permanent establishment (the business profits article), or to limit the rate of tax applicable to certain profits (such as taxation of dividends and interest income).

¹⁵ See for example the Australian foreign tax credit system.

II THE LEGAL FRAMEWORK OF DOUBLE TAX CONVENTIONS

Double tax conventions are international agreements that give rise to international obligations between sovereign states. The interpretation and application of such conventions is governed by the general rules of international public law (whether customary or as codified in the Vienna Convention) in the same way as any other political or economic treaty. However, double tax treaties differ from other economic or political treaties in that they are intended to operate within the domestic legal systems of the contracting states. In this sense, a double tax convention has a dual character as an international agreement that binds two nation states and as domestic law that binds subjects within its scope.¹⁶

In view of their essentially international character, a question arises as to the manner in which double tax conventions are given the force of law domestically so as to give rise to private justiciable rights and obligations. The constitutional and legal systems may give treaties the force of law in three different ways:¹⁷

1. International treaties may be self-executing and create rights and liabilities without the need for legislation or parliamentary approval. Examples include Belgium, the Netherlands and the United States of America.
2. The incorporation of international treaties into domestic law may not be automatic but require some form of parliamentary approval in order to have the force of law. Examples include Germany and Italy.
3. International treaties have no legal effect whatsoever upon the rights and obligations of subjects unless and until the treaty is incorporated into domestic law by a specific enactment of the relevant parliament of the member states. Examples include Australia, Canada, Denmark, Israel, New Zealand and the United Kingdom.

In the Australian, United Kingdom and Canadian constitutional systems, whilst treaties are matters for the executive involving the exercise of prerogative power, it is within the exclusive purview of the legislature or Parliament and not the executive to make or alter municipal law. The exercise of such prerogative power by the executive, without more, does not effect any change to national law

¹⁶ Philip Baker, *Double Taxation Conventions and International Tax Law* (2nd ed, 1994) 6. *Taxation Ruling TR 2001/13*, Australian Taxation Office, <<http://law.atolaw.gov.au/atolaw/view.htm?docid=TXR/TR200113/NAT/ATO/00001>> as at 3 October 2005, para 8. For a comprehensive examination of the legal issues involved in the negotiation and incorporation of treaties, see Ivan Anthony Shearer, *Starke's International Law* (11th ed, 1994).

¹⁷ Klaus Vogel & Rainer Prokisch, *Interpretation of Double Taxation Conventions, General Report*, Cahiers Volume LXXVIIIa (1993) 59.

otherwise the executive would have the power of legislation.¹⁸ If the national executive decides to incur the obligations of a treaty that involves or requires the alteration of domestic law, then the executive must bear the risk of failing to obtain the necessary assent of Parliament to legislate such obligations into law and thus be in breach of its international obligations.

In Australia, double tax agreements are integrated into Australian domestic law by incorporation as schedules to the *International Tax Agreements Act 1953* (Cth). Under Article VI, Clause 2 of the US Constitution, both domestic statutes and US treaties form a part of the 'supreme law of the land'. Australia does not have an equivalent constitutional principle, but rather as a matter of law treaties form a part of domestic law as ordinary statutory law and hence are treated in the same manner as ordinary statutes governed by domestic law conflict principles.

In this respect, as is the case in the US, a treaty may be overridden by a later inconsistent legislation which could amend the *International Tax Agreements Act 1953* (Cth) and override and/or modify a particular treaty even though that may render the Commonwealth of Australia in breach of its international treaty obligations. Following the decision in *Lamesa*,¹⁹ Australia amended the *International Tax Agreements Act 1953* (Cth) in order to permit the Commissioner to look through land rich companies.²⁰ However, in the application of common law principles of statutory interpretation, Australian courts would in general and to the extent permitted by the terms of the conflicting instrument, prefer a construction that conforms to international obligations and established rules of international law.²¹

In so far as the relationship between double tax conventions and the *Income Tax Assessment Acts* of 1936 and 1997 (Cth) is concerned, s 4(2) of the *International Tax Agreements Act 1953* (Cth) provides:

The provisions of this Act have effect notwithstanding anything inconsistent with those provisions contained in the Assessment Act (other than section 160AO or part IVA of that Act) or in an Act imposing Australian tax.²²

¹⁸ *Attorney General for Canada v Attorney General for Ontario* [1937] AC 326, (Lord Atkin speaking for the Judicial Committee) 347. *Koowarta v Bjelke-Peterson* (1982) 153 CLR 168, 224 (Mason J); *Queensland v The Commonwealth* (1989) 167 CLR 232, 239.

¹⁹ *FCT v Lamesa Holdings BV* (1997) 97 ATC 4752.

²⁰ *International Tax Agreements Act 1953* (Cth), s 3A.

²¹ *Jumbunna Coal Mine NL v Victorian Coal Miners' Association* (1908) 6 CLR 309, (O'Connor J) 363; *Polites & Kandiliotes v The Commonwealth* (1945) 70 CLR 60.

²² The 'Assessment Act' is defined in s 3(1) to include both the *Income Tax Assessment Act 1936* (Cth) and the *Income Tax Assessment Act 1997* (Cth).

The principal effect of this provision is to give legal primacy to double tax conventions over the income tax legislation except over the general anti avoidance rule as contained in part IVA. This priority rule is further enforced by section 177B(1) of the *Income Tax Assessment Act 1936* (Cth), which provides that nothing in the provisions of the *International Tax Agreements Act 1953* (Cth) is to be taken to affect the operation of part IVA. It follows that if there is any inconsistency between a double tax treaty and part IVA, the latter prevails. This is significant because Australia's treaties with other countries do not contain a general anti-avoidance rule because that rule is preserved in part IVA.

Consistent with the Australian legislative design and drafting tradition, the *International Tax Agreements Act 1953* (Cth) and the double tax agreements to which it gives effect 'present a labyrinthine maze which is a tribute to the obliquity of the draftsman's art'.²³ Subject to this reservation, the *International Tax Agreements Act 1953* (Cth) operates to incorporate bilateral double tax conventions between Australia and other nations into domestic law and give priority to the treaty over domestic tax legislation. Unless and until a treaty is incorporated into the domestic laws of Australia, foreign residents or nationals cannot gain any rights for relief from double taxation that are enforceable in Australian courts. The same is also true in the context of the UK.²⁴

III PRIMARY PRINCIPLES OF TREATY INTERPRETATION

The interpretation of a double tax treaty determines the ambit and content of the rights it confers and the obligations it imposes upon affected subjects. Although double tax conventions are incorporated into domestic law, their interpretation must be cognisant of their essentially international character and their contractual character. In this sense the process of treaty interpretation is not concerned with the search for meaning consistent with the objects and purposes of a particular sovereign/legislature, but rather with the search for meaning that is consistent with the mutual intent and expectations of the sovereign contracting parties. The relevant mutual intent and expectations, once identified, may then be imputed to the legislature whose statutory instrument is under consideration by its national courts.

This proposition emphasises the significance of the text or terms of the treaty as the best evidence and expression of mutual intentions and expectations. That is, the

²³ *FCT v Sherritt Gordon Mines Ltd* (1977) 137 CLR 612 (Mason J) 618.

²⁴ For an examination of issues concerning the incorporation of conventions into domestic law see John F. Avery Jones, 'Tax Treaty Interpretation in the United Kingdom', in Michael Lang (ed), *Tax Treaty Interpretation: EUCOTAX Series on European Taxation*, Vol 3 (2001); and Graham Corney, 'Mutant Stare Decisis: The Interpretation of Statutes' (1994) 18 *University of Queensland Law Journal* 50.

intentions of the contracting states must be found in the provisions of the treaty. In addition, this proposition focuses the process of interpretation upon mutual subject matter and sources and diminishes the role and relevance of unilateral materials, understandings and expectations.

In an attempt to reconcile diverse legal and taxation systems, differences in language and legal conceptions, the text of double tax conventions is often expressed in relatively general terms. Further, reliance upon general expressions of principles and standards is essential in order to regulate in advance a sphere of conduct or subject matter that is unknown at the time of negotiations and to address indeterminacy of aim which derives from the inability of contracting parties to anticipate and foresee all possible combinations of circumstances which call for the application of the relevant double tax treaty. The generality of the language used to express the intent of the treaty parties permits greater flexibility in the operation of double tax conventions, and leaves scope for discretion to each party with respect to the specific steps necessary to implement their respective obligations.

General expressions of principles by their nature rely on judicial interpretation to define their content and focus their legal scope and practical application. In discharging that function, it is critical that the respective national courts adopt broad and flexible principles of interpretation unconstrained by technical or rigid domestic rules and precedents. Whilst the process of interpretation is often viewed or explained as a search for the common intention of the contracting parties, in truth it is an act of creation or invention rather than discovery. In effect, courts impute or impose a purpose or intention to the contracting parties by reference to recognised canon of international legal interpretation. The imputed intention is only binding upon the state whose domestic courts made that determination. Therefore it is conceptually and practically possible that the contracting states may be imputed conflicting intentions by their respective national courts. This possibility emphasises the need for general international principles for the interpretation of treaties.

A *Common Themes and Approaches*

The Vienna Convention on the Law of Treaties governs the interpretation of double tax conventions. Whilst many countries have not signed or have signed but not ratified the convention, it is generally accepted that the Vienna Convention substantially codifies customary international law and therefore the interpretation of international treaties is governed by its rules of interpretation.²⁵ The interpretative Articles 31 and 32 of the Vienna Convention express generally accepted principles of international law.

²⁵ *Commonwealth v Tasmania* (1983) 158 CLR 1, 93–4; *Fothergill v Monarch Airlines Ltd* [1981] AC 251, 276 and 282.

Article 31(1) of the Vienna Convention provides:

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

This statement expresses a general rule or principle of treaty interpretation to guide national institutions and consequently promotes greater international uniformity and certainty in the interpretation of treaties. However, the general rule of interpretation is formulated in open and broad terms and hence leaves considerable scope for interpretation and hence variation across nations. Nevertheless, it is possible to discern a number of distinct and sufficiently defined principles from the terms of the general rule of interpretation as contained in Article 31(1).

The general rule refers to the treaty as a whole and hence mandates a more holistic and ordered approach to the interpretation of treaties.²⁶ The holistic approach may require a consideration of both the text and the object and purpose of the treaty in order to ascertain its true meaning.²⁷ This does not preclude a consideration of the meaning and purpose of a particular article in issue but rather requires the interpretation of specific and particular articles by reference to the object and purpose of the treaty as a whole.

It is important to recognise, however, that whilst the specific terms or articles of a treaty must be interpreted by reference to the broader goals and objectives of the whole treaty (as required by the holistic approach), the specific and particular terms of the treaty form the primary source from which the actual objects of the treaty as a whole may be discerned. In other words, courts are not permitted to stray away from the text in search for some general object or purpose that can then be used as the relevant benchmark by reference to which the meaning of the specific terms of the treaty may be determined. This brings into focus the significance and primacy of the text of the treaty.

It is widely accepted that the general rule of interpretation gives primacy to the text of the treaty.²⁸ There may be considerable disagreement about the meaning of

²⁶ *Golder v United Kingdom* (1975) 1 EHRR 524, (Zekia J) 544 (European Court of Human Rights); International Law Commissioner, Reports of the Commission to the General Assembly [1966] 2 *Yearbook of the International Law Commission* 169, 219–20; *Applicant A v Minister for Immigration & Ethnic Affairs* (1997) 190 CLR 225, (Brennan CJ) 383; (McHugh J) 396–7.

²⁷ *Applicant A v Minister for Immigration & Ethnic Affairs* (1197) 190 CLR 225, (Brennan CJ) 383; (McHugh J) 396.

²⁸ *Fothergill v Monarch Airlines Ltd* [1981] AC 251; *United States v Stuart* 109 S. Ct. 1183 (1989); *Applicant A v Minister for Immigration & Ethnic Affairs* (1197) 190 CLR 225, (McHugh J) 396; International Law Commissioner, Reports of the

particular terms or articles, but there can be no doubt about what the parties actually said. In other words, the text is the only certain expression of the ideas and expectations of the contracting parties. Further, the need for legal certainty and elementary justice demands that the rules should be ascertainable by affected persons by reference to identifiable and accessible sources. The primary source that the contracting states intended domestic courts and subjects to refer to is the language of the treaty itself, which is approved as accurately expressing their mutual intentions and expectations.

Another policy in favour of giving primacy to the text of the treaty was explained by McHugh J in *Applicant A* in the following terms:

The need to give the text primacy in interpretation is accentuated by the tendency of multi-lateral instruments to be the result of various compromises by various States or groups of States. If the subjective intentions of their representatives were the criterion, the interpretation of many international instruments might be impossible.²⁹

A treaty must be interpreted and applied in accordance with its text because the text must be presumed to be the true or authentic expression of the intentions and expectations of the parties.³⁰ Therefore, where there is no reasonable indication that the application of the terms of the treaty in accordance with their tenor and obvious meaning effects a result inconsistent with the intent and expectations of its sovereign parties, it would be improper for a court to sanction departure from the clear import of the text of the treaty. Deviation from the text must be limited to circumstances where its strict application would unambiguously and unequivocally frustrate the mutual intention and expectations of the contracting states.

The significance of the text of the law was clearly emphasised by Lord Diplock in *Fothergill* where the House of Lords was concerned with the interpretation of

Commission to the General Assembly [1966] 2 *Yearbook of the International Law Commission* 169, 218. The primacy of the text of the treaty as a general principle is supported by the national courts of many European and common law countries: see the various national reports in the annual congress of the International Fiscal Association, *Interpretation of Double Taxation Conventions*, Cahiers Volume LXXVIIIa (1993). In relation to the Japanese approach, Nakazato commented that Article 84 of the Japanese Constitution requires a more strict interpretation of taxation statutes and that the wording of a statute is 'important'. The learned writer added that Japanese courts generally have interpreted treaties in the same manner as they interpret domestic law: *Interpretation of Double Taxation Conventions*, Cahiers Volume LXXVIIIa (1993) 410–11, cited in *Japan National Reporter*.

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Above n 27, 397.

³⁰

International Law Commissioner, Reports of the Commission to the General Assembly [1966] 2 *Yearbook of the International Law Commission* 169, 218.

legislation designed to give effect to the Warsaw Convention. His Lordship warned that elementary justice demands that the rules by which citizens are bound should be ascertainable by reference to identifiable and accessible sources, and added:

The source to which Parliament must have intended the citizen to refer is the language of the Act itself. These are the words that Parliament has itself approved as accurately expressing its intentions. If the meaning of those words is clear and unambiguous and does not lead to a result that is manifestly absurd or unreasonable, *it would be a confidence trick by Parliament and destructive of all legal certainty* if the private citizen could not rely on that meaning but was required to search through all that had happened before and in the course of the legislative process in order to see whether there was anything to be found from which it could be inferred that Parliament's real intention had not been accurately expressed by the actual words that Parliament had adopted to communicate it to those affected by the legislation.³¹ [Emphasis added]

In similar terms, the US Supreme Court has adopted an approach that permits departure from the terms of the treaty only in situations where the application of the words in accordance with their obvious meaning would effect a result inconsistent with the intent and expectations of its signatories.³² In *Stuart*, Justice Scalia emphasised the importance of giving effect to the clear import of treaty language and stated:

Of course, no one can be opposed to giving effect to the intent of the treaty parties. The critical question, however, is whether that is more reliably and predictably achieved by a rule of construction which credits, when it is clear, the contracting sovereigns' carefully framed and solemnly ratified expression of those intentions and expectations, or rather one which sets judges in various jurisdictions at large to ignore that clear expression and discern a 'genuine' contrary intent elsewhere. To ask that question is to answer it.³³

In that case Justice Scalia suggested that it may be inappropriate to sanction a deviation from 'clear text even if there were indications of contrary intent'.³⁴ Whatever may be said of the legal reasoning that led to this proposition, it is either too strictly stated or is intended to be heavily qualified by the requirement of a clear

³¹ *Fothergill v Monarch Airlines Ltd* [1981] AC 251, 263.

³² *Maximov v United States*, 373 US 49 (1963).

³³ *United States v Stuart*, 489 US 353, 371 (1989); 109 S. Ct. 1183, 1194 (1989). On this issue the American Law Institute has recommended that 'the express language of an income tax treaty is to be applied in accordance with its terms unless it is clear that this would frustrate the mutual expectations of the countries which entered into the treaty': Federal Income Tax Project, *International aspects of United States Income Taxation II: Proposals on United States Income Tax Treaties* (1992) 45.

³⁴ *Ibid.*

text. Where the text is clear, then that must represent the authentic expression of the intentions of the parties otherwise it must be assumed that the parties did not mean what they said. If it is accepted that the primary source of meaning is the text of the treaty, then a clear text would normally conclude the question of interpretation and indications of a contrary intent would not be expected to receive much weight. Where there are unequivocal and unambiguous indications that the parties' intent and expectations miscarried by reason of an error then there may be sound reasons in principle and policy for courts to depart from the express terms of the treaty.

To place so much emphasis upon the importance of the text of the treaty does not demand or imply an interpretative approach that disregards the essential character of an international treaty as an international instrument designed to bring about consensus between two or more diverse nations. Whilst treaties are subject to careful consideration and protracted negotiations before they are entered into and are drawn up by persons with expertise in both international law and the subject matter of the treaty (and hence are competent to express their meaning and to adopt appropriate words to express the purposes of their respective contracting states), treaties nevertheless rely on general concepts and principles to express the intent and purposes of the contracting parties.

General concepts and principles are employed in order to reconcile often very different taxation systems, language and legal conceptions. As noted above, reliance upon general principles and standards is essential in order to regulate in advance a sphere of conduct or subject matter that is unknown at the time of negotiations and to address indeterminacy of aim which derives from the inability of contracting states to anticipate and foresee all possible permutations and combinations of circumstances which call for the application of the relevant treaty. In addition, there is a temporal dimension to that generality of principle and language — that is treaties are designed to deal with future changes to the respective taxation systems of the contracting states. The need to anticipate and deal with possible future changes is all the more critical because treaties are very difficult to amend and often last a very long time.

This may explain why international treaties often fail to exhibit the precision of domestic legislation. It follows that, in the development of interpretative rules, national courts must recognise that treaties cannot be and are not expected to be applied with 'taut logical precision'.³⁵ In fact the application of strict logic may provide a degree of comfort and confidence in an otherwise flawed process and an undesirable result.

³⁵ Above n 27, (McHugh J) 397. His Honour cited with approval the comments of Zekia J in the European Court of Justice in *Golder v United Kingdom* (1975) 1 EHRR 524, 544.

It further follows that a treaty must be construed liberally in order to give effect to the purposes that animate it.³⁶ Where the terms of the treaty admit of two competing constructions, then the more liberal interpretation that expands the rights claimed under it is to be preferred.³⁷ The proposition that treaties must be construed liberally is arguably an implicit requirement of article 31(1) of the Vienna Convention.³⁸ That article imposes a mandatory requirement that a treaty shall be interpreted in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. The interpretation of the terms within the context, object and purpose of the treaty implies a more creative and liberal rather than a strict or rigorous method to treaty interpretation.

The terms of the general rule raise a question as to the circumstances that require or permit recourse to the context, object and purpose of the treaty. The question implies a two-step process that first ascertains the ordinary meaning to be given to the terms of the treaty and then determines whether recourse to the context, object and purpose of the treaty is necessary. This appears to be the approach advocated by the American Law Institute where, in one of its international income tax projects, it was stated that the ‘object and purpose of the treaty do not govern its interpretation but are taken into account in interpreting its express terms’.³⁹

It is difficult to envisage how it is practically and conceptually possible to determine the meaning of a certain term or expression in a treaty without some referent to guide and focus the undertaking. The principal referents that guide the process of interpretation and give the specific and particular terms of the treaty content have to be the context within which the relevant terms were expressed and the object and purpose that the contracting states sought to achieve. Without reference to the relevant context, object and purpose, treaty interpretation would be

³⁶ *Barcardi Corp. of America v Domenech* 311 US 150, 163 (1940); *United States v Stuart*, 489 US 353, 368 (1989); 109 S. Ct. 1183, 1192 (1989); *Shipping Corporation of India Ltd v Gamlen Chemical Co (Australiasia) Pty Ltd* (1980) 147 CLR 142 (Mason and Wilson JJ) 159; *Chan Yee Kin v Minister for Immigration & Ethnic Affairs* (1989) 169 CLR 379, (Gaudron J) 412–3; *Applicant A v Minister for Immigration* (1997) 190 CLR 225 (McHugh J) 397; *James Buchanan & Co Ltd v Babco Forwarding & Shipping (UK)Ltd* [1978] AC 141, 152.

³⁷ *Barcardi Corp. of America v Domenech*, 311 US 150, 163 (1940); *United States v Stuart*, 489 US 353, 368 (1989); 109 S. Ct. 1183, 1192 (1989).

³⁸ Above n 27, (McHugh J) 397. Whilst he did not suggest that the liberal approach was implicit in the terms of the Vienna Convention, His Honour made the following comment: ‘the mandatory requirement that the courts look to the context, object and purpose of treaty provisions as well as the text is consistent with the general principle that international instruments should be interpreted in a more liberal manner than would be adopted if the court was required to construe exclusively domestic legislation’.

³⁹ Above n 6, 33.

an arbitrary process that may produce random and anomalous results, and there would be no reasonable means of knowing whether the attempt to give effect to the intention of the contracting parties miscarried.

It therefore follows that to the extent that the question and proposition suggest a two-step process, they would be based on an erroneous conception of the nature of treaty interpretation mandated by the Vienna Convention.

It is submitted that treaty interpretation is a unitary process that seeks to determine the ordinary meaning of the terms of the treaty in their context and in accordance with its objects and purposes. Put differently, a treaty must be construed as an integrity in a manner that would advance rather than defeat its essential character and purpose. This proposition precludes a strict and literal construction, which fails to take into account the relevant context, object, and purpose of the treaty.⁴⁰

From the foregoing, it follows that the process of treaty interpretation as required by the general rule contained in article 31(1) of the Vienna Convention may be expressed as follows:

- (a) The rationale of treaty interpretation is to determine and give effect to the mutual intent and expectations of treaty parties.
- (b) The relevant or guiding intent is not the subjective intentions of the parties but rather the objectively determined object and purpose of the treaty as a whole. The object and purpose, when identified, must inform the court as to the intended meaning or application of the specific and particular terms of the treaty.
- (c) The primary source or evidence of that intent is the actual text of the treaty. The text is presumed to be the 'authentic expression' of the intentions and expectations of the parties and may itself reveal the object and purpose of the treaty or at least assist in ascertaining the object and purpose of the treaty.
- (d) The text or terms of the treaty cannot be interpreted in a vacuum but rather within the context in which they appear. It is that context which animates

⁴⁰ In *James Buchanan & Co Ltd v Babco Forwarding & Shipping (UK) Ltd* [1978] AC 141, Lord Wilberforce commented 'I think that the correct approach is to interpret the English text ... in a normal manner, appropriate for the interpretation of an international convention, unconstrained by technical rules of English law, or by English legal precedent, but on broad principles of general acceptance': 152. These comments were referred to with approval by Dawson J in *Applicant A v Minister for Immigration* (1997) 190 CLR 225, 388. See also the comments in *The Commonwealth v Tasmania* (1983) 158 CLR 1, 302; and *State of Victoria v Commonwealth of Australia* (1996) 187 CLR 416, 736.

the terms of the treaty and facilitates the identification of the true and intended meaning and application.

Under article 31(2) of the Vienna Convention, the context for the purposes of the interpretation of a treaty includes, in addition to the text, any agreement or instrument that was made by the parties in connection with conclusion of the treaty and accepted as an instrument that relates to the treaty. In addition, Article 32 permits recourse 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 article 31; or
- To determine the meaning when the interpretation according to article 31 leaves the meaning ambiguous or obscure or leads to a result which is manifestly absurd or unreasonable.

An examination of the full significance of articles 31(2) and 32 of the Vienna Convention is a substantial subject that is beyond the scope of this paper.⁴¹ However, it is critical to note that while recourse to a broad range of material (*travaux praeparatorioires* or legislative history, as it is called in the United States) may give the appearance of a comprehensive inquiry, however, it may in fact misdirect the process of interpretation and give a false impression as to the true intention and expectations of the parties. *Travaux praeparatorioires* are only aids to interpretation of the relevant terms of the treaty to be used to discern the intention and expectations of the parties but not to displace the otherwise clear import of the text of the treaty. As required by the Vienna Convention, *travaux praeparatorioires* should only be used to confirm or determine the meaning of terms that are ambiguous.

Further, it is critical to exercise caution before opening the books of history because the more extensive the relevant context and supplementary materials, the greater the burden upon the courts, the more protracted the proceedings would be and the greater the cost to the affected taxpayer and the revenue. High costs can operate as a barrier to taxpayers challenging an otherwise erroneous assessment and hence can have the practical effect of denial of natural justice. Further, natural justice or due process demands that materials that can affect the liability to taxation and the outcome of a dispute with the revenue must be readily available to the affected taxpayer.

⁴¹ For a detailed examination of the significance and meaning of articles 31(2) and 32 of the Vienna Convention, see John Avery-Jones et al, 'The Interpretation of Tax Treaties With Particular Reference to Article 3(2) of the OECD Model – II', [1984] *British Tax Review* 90.

Finally, very limited if any weight should be attributed to unilateral material. Treaty interpretation is the quest for that which is common, that is common understandings and expectations rather than for that which is individual. In *Stuart*, Justice Scalia (concurring in judgment) regarded the use of pre-ratification extrinsic material to confirm an unambiguous text as an ‘innocuous practice’ and rejected the need to refer to the pre-ratification Senate materials and said that the use of that material:

...is like determining the meaning of a bilateral contract between two corporations on the basis of what the board of directors of one of them thought it meant when authorising the chief executive officer to conclude it.

There is something, too, which shocks the conscience in the idea that a treaty can be put forth as embodying the terms of an arrangement with a foreign power or an Indian tribe, a material provision of which is known to one of the contracting parties, and is kept in the background to be used by the other only when the exigencies of a particular case may demand it.⁴²

The object and purpose of a double tax convention has generally been identified as the avoidance of double taxation or elimination of international double taxation. However, relief from double taxation can be provided by unilateral measures to limit or forego domestic taxing rights. Such measures, unless reciprocated, could result in a shift in taxation revenue from one state to another and in possible inefficiency in the global allocation of capital and investment.

Double taxation conventions provide an agreed framework for the distribution of taxation revenue between the contracting parties. Whether such a particular tax-sharing framework is equitable or efficient is a completely different issue, which depends on the terms of the treaty and the nature of the arrangement created by it.⁴³ In *Maximov*, the US Supreme Court affirmed that, in the light of the different tax structures of nations, it is virtually impossible for double tax conventions to ‘assure complete and strict equality of treatment’. The court added that the general purpose of double tax conventions was to ‘facilitate commercial exchange through elimination of double taxation resulting from both countries levying on the same transaction or profit’.⁴⁴

Viewed in this way it is not entirely correct to state, as an absolute proposition, that the object of double tax conventions is the avoidance or elimination of double taxation. Double tax conventions only seek to avoid or eliminate double taxation in

⁴² Above n 33, 1195 (1989).

⁴³ There are no generally accepted principles to determine what is and is not equitable or fair. On different occasions both capital importing and capital exporting nations commonly complain that the allocation of taxation revenue is unfair: A J Easson, *International Tax Reform and the Inter-nation Allocation of Tax Revenue* (1991) 2.

⁴⁴ *Maximov v US* 10 L. Ed. 2d 184, 188 (1963).

the circumstances specified in the treaty. Therefore, where a particular interpretation results in double taxation, that result does not necessarily mean that it is contrary to the object and purpose of the convention. That conclusion must ultimately depend on the terms of the treaty and perceptions as to the intention and expectations of the contracting parties.

In addition to the distributive framework, double tax conventions can facilitate international trade and investment by removing or preventing the erection of tax barriers to the free international exchange of goods and services and the free international movement of capital and persons.⁴⁵ Double tax conventions have been used as an instrument to prevent or eliminate discriminatory taxation.⁴⁶ The significance of non-discrimination is borne out by the fact that the Treaty of Rome did not contain provisions about direct taxation except for a series of non-discrimination articles.⁴⁷ Finally, double tax conventions can be used to manage fiscal evasion and avoidance.⁴⁸

The foregoing identified a number of possible objects and purposes that should be considered in determining the ordinary meaning of the terms of the treaty.

Finally, the general interpretative rule as contained in the Vienna Convention imposes an obligation to interpret a treaty in good faith in accordance with the ordinary meaning to be given to the terms of the treaty. The expression ‘good faith’ suggests an absence of ‘bad faith’ in the sense of acting bona fide with honest and sincere intentions uninfluenced by purely national considerations and policies. An interpretative approach guided by the intent and expectations of the parties regardless of national interests would necessarily produce a manifestly sensible and reasonable outcome and would in that sense be in good faith. Finally, the general rule mandates a search for the ordinary meaning of the terms of the treaty. The ordinary meaning is not necessarily that which is common or that of everyday usage.⁴⁹ The expression ordinary meaning may refer to a specific technical language that have developed in a specialised area such as taxation, or to uniform

⁴⁵ Above n 6. Similar comments were made in the UN Manual that double tax conventions provide for the free flow of international trade and investment and the transfer of technology: at page 1.

⁴⁶ UN Manual at page 1; Philip Baker, *Double Taxation Conventions and International Tax Law* (2nd ed, 1994) 12.

⁴⁷ *Treaty Establishing the European Economic Community*, opened for signature 25 March 1957, 298 UNTS 11, art 220 (entered into force 1 January 1958).

⁴⁸ Above n 44.

⁴⁹ K Vogel et al, above n 12, 37.

international tax language, the primary source of such international tax language is the OECD commentary.⁵⁰

IV THE PRINCIPLE OF COMMON INTERPRETATION OR UNIVERSAL MEANING

The primary functions of double tax conventions are to allocate tax rights in accordance with the agreed framework and to eliminate tax barriers so as to facilitate international trade and investment. These objectives are only achieved where the treaty is interpreted and applied consistently by the courts in both contracting states. An inconsistent interpretation of a treaty would create scope for double taxation and undermine international trade and investment and therefore undermine rather than advance the object and purpose of the treaty. It therefore follows, to the extent that article 31(1) mandates an interpretation of a treaty as an integrity in the light of its object and purpose, the Vienna Convention requires the contracting states to embrace, as far as possible, a common interpretation.

A *Reference to Decisions of Foreign Courts*

The distributive and economic objectives of double tax conventions can only be achieved through the consistent application of the treaty by the authorities and courts in both contracting states. This raises an issue as to whether, and the extent to which, national courts of one contracting state should take into consideration interpretative decisions of national courts of the other contracting state on a similar treaty article or issue.

Perhaps the most notable attribute of foreign decisions is that they are often inconsistent and fail to disclose sound principles capable of consistent and coherent application. Such inconsistency is the product of the humanity that characterises judicial reasoning and decision-making process, which itself is influenced by cultural and political traditions and the legal systems. Consistency in the application of common law principles within a court hierarchy is only possible because of the doctrine of precedent where lower courts are bound by the *ratio decidendi* of the decisions of higher court. Without the binding effect of the *ratio decidendi* of a decision, it would be reasonable to expect that divergences would emerge in the development and application of common law principles. In addition, agreement as to the principles of construction does not necessarily translate into agreement as to application of a treaty. It is not uncommon for judges to refer to the same principles but arrive at different conclusions.

⁵⁰ *Thiel v FCT* (1990) 171 CLR 338. Here the High Court considered the meaning of the word enterprise, which had no exact counterpart in domestic laws, and had recourse to the international sources before concluding that the term may cover both an activity itself and the means by which an activity is engaged in.

Expressed as an ideal, the principle of common interpretation as between contracting states can create a dilemma as to the apposite interpretation that should be adopted where a term has been interpreted inconsistently. For example, if Australia uses a particular term in its treaties with the United States and France and the national courts of the United States and France adopt different views as to the meaning and operation of that particular term, then a question arises as to what interpretation Australian courts should adopt. If an interpretation that is common with each were adopted, then the same term would have different meanings in Australia. Whilst that result is not entirely inconceivable because the respective parties may have intended the relevant terms to have a special meaning, that result is highly undesirable and illogical where the interpretation is concerned with a term that forms a part of the international tax language.

From the foregoing, it follows that the goal of common interpretation does not, as a matter of law and policy, necessarily require the national courts to accept and follow the relevant foreign decisions without review, but rather it requires domestic courts to take into consideration the decisions of the courts of the other contracting state in forming conclusions as to the preferred interpretations. There always remains the question whether it would be constitutionally permissible for domestic courts to follow foreign decisions without warrant or legal authority. Lord Denning has suggested that a court should follow foreign decisions as if they were binding and added ‘even if I disagreed, I would follow them in a matter which is of international concern’.⁵¹ It is highly unlikely that this approach would be shared by, or command the support of other courts because it would effectively mean that national courts would relinquish their constitutional powers and obligations to foreign courts. It further means that the first interpretation becomes the final interpretation regardless of whether it is ill conceived, inappropriate or erroneous.

The courts of a number of countries have addressed the desirability of a uniform interpretation of double tax conventions. In *CIR v JFP Energy Incorporated*,⁵² the New Zealand Court of Appeal considered the application of Article 15 of United States/New Zealand double tax convention. More specifically, the court considered the meaning to be attributed to the words ‘the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State’, which appear in that Article. The court referred to the US Treasury Department’s Technical Explanation of the Agreement tendered to the Senate Foreign Relations Committee for the purposes of gaining the advice and consent of the Senate to that treaty and stated:

⁵¹ *Corocraft Ltd & Vendome Jewels Ltd v Pan American Airways* [1968] 3 WLR 1273, 1283.

⁵² (1990) 14 TRNZ 617.

[I]t is obviously desirable that the same interpretation answer should be given whether a double tax treaty question arises for determination in New Zealand or the US and in our view appropriate consideration should be given to the considered official opinion of the other party to the treaty as to its meaning. In this case, that Treasury pronouncement reinforces the conclusions we have reached as to that meaning.⁵³

In a decision concerning the application of the Netherlands/Australia double tax convention, the Australian Federal Court stated:

Where the construction of an international treaty arises, evidence as to the interpretation of that or subsequent treaties in one of the participating countries forms part of the matrix of material to which reference could properly be made in an appropriate case. As presently advised we would not wish it to be thought that a limited view of the material to which reference could be made in interpreting a double tax treaty should be taken. Had there been some decision of an appropriate Dutch court interpreting a treaty with identical or similar language, then, in our view, evidence of such a decision might well have been admissible.⁵⁴

A similar approach has been adopted by the courts in Canada,⁵⁵ in Japan⁵⁶, the United Kingdom,⁵⁷ and the United States.⁵⁸ On this issue, the American Law

⁵³ Ibid, 623–4.

⁵⁴ Above n 19, 4757 (Burchett, Hill and Emmett JJ). The Australian High Court has, in indirect terms, supported the approach of the Federal Court. In *Shipping Corporation of India Ltd v Lamco Chemical Co (Australasia) Pty Ltd* (1980) 147 CLR 142, the High Court stated that ‘in the interest of uniformity’ a national court should construe rules formulated by an international convention in a normal manner based on ‘broad principles of general acceptance’: 159. Further, in *Thiel v FCT* (1990) 171 CLR 338, whilst the High Court did not expressly accept the principle of common interpretation, the court referred to the international tax language and the need to interpret the relevant provision in the context of the agreement itself as an international agreement: 344, 347 and 356. Finally, in *Chan Yee Kin v Minister for Immigration & Ethnic Affairs* (1989) 169 CLR 379, the High Court considered the meaning of the term ‘refugee’ and in arriving at its decision referred to the decisions of the courts of England, the United States and Canada.

⁵⁵ *Canadian Pacific Limited v The Queen* 76 DTC 6370 (FCA); and *Utah Mines Ltd v The Queen* 92 DTC 6194 (FCA).

⁵⁶ Decision of Tokyo District Court, 14 April 1965, 11–5 Shomu Geppo 817, cited by Minoru Nakazato, Report on Japan, International Fiscal Association, *Interpretation of Double Taxation Conventions*, Cahiers Volume LXXVIIIa, (1993) 414.

⁵⁷ Above n 31. See also the decision in *IRC v Commerzbank AG* [1990] STC 285, 63 TC 218 where the English High Court rejected reference to, inter alia, a US decision on grounds that it would qualify the clear words of the treaty.

⁵⁸ *Donroy Ltd v United States*, 301 F 2d 200, 207 (9th Cir. 1962) where the court cited a decision of the Canadian Tax Appeal Board; *Pigeon River Improvement, Slide &*

Institute suggested that relevant decisions of foreign courts may be regarded as evidence of the practice of the parties and given substantial weight as an aid to interpretation.⁵⁹

From the foregoing, it is possible to gather a general theme or approach adopted by various national courts that accords decisions of superior foreign courts considerable weight and persuasive value in formulating their ultimate conclusions as to the interpretation and application of a treaty. Unless a national court concludes that the interpretation given by the relevant foreign court was manifestly erroneous it would not be desirable to reach a different conclusion. Further, in the interest of global uniformity, domestic courts should also consider foreign decisions (unrelated to the treaty in issue) that interpret treaty terms that form a part of the international tax language.

The persuasive value and the weight to be accorded to decisions of foreign courts must depend on the standing of the particular court in its hierarchy and the extent to which its decisions are binding on courts of inferior jurisdiction. Decisions of inferior courts may be overturned on appeal or overruled by a subsequent decision of a higher court. Similarly, decisions that are not binding on other courts within a hierarchy may be superseded or contradicted by subsequent decisions. In these instances, there would be no reliable and sound basis upon which uniformity can be established.⁶⁰

B Relevance of the OECD Model and Commentary

The OECD Model Tax Convention is designed to provide a uniform framework within which problems and issues concerning international juridical double taxation may be resolved. The model provides a comprehensive foundation of uniform principles, definitions, rules, and methods and agreement on a common interpretation.⁶¹ In *Thiel*, the High Court of Australia considered the meaning of the expression ‘profits of an enterprise of one of the Contracting States’ in Article 7 of the Australia/Switzerland double tax convention. The Court held that the model

Boom Co v Charles W Cox Ltd, 291 US 138 (1934) where the court cited the interpretation of the same treaty by the Canadian Supreme Court; *Eastern Airlines Inc v Floyd et al* 499 US 530; 111 S. Ct. 1489. In that case, the Supreme Court considered the legal meaning of the French expression ‘lesion Corporelle’ in the Warsaw Convention and sought guidance from French decisions (there were none) and from French treaties and scholarly writing covering the period leading up to the Warsaw Convention (and found none). See page 538, 1495.

⁵⁹ Above n 6, 38.

⁶⁰ Above n 31, (Diplock LJ) 267.

⁶¹ The OECD Committee Report on Fiscal Affairs, Model Tax Convention on Income and on Capital (Condensed version) OECD, April 2000, p 8.

convention and official commentaries may be used in the construction of double tax conventions. The Court held that the model and commentaries form either a part of the relevant context within which the agreement was formed or were supplementary means of interpretation within the terms of the Vienna Convention (Articles 31 and 32). The Court referred to the model and commentaries even though Switzerland was not a party to the Vienna Convention because the applicable rules which it lays are no more than an indorsement or confirmation of existing practice and reflect the customary rules of the interpretation of treaties.⁶²

This approach is sound as a matter of principle and logic because it recognises that the parties must have considered and applied the terms of the model and explanation of the commentary. Unless a contrary intention appears on the terms of the treaty, the model and commentary arguably capture the mutual intention and expectations of the contracting states. This explains why many other countries have adopted a similar approach.⁶³

The models and commentaries have been revised over a number of years, most recently to deal with the growth of e-commerce.⁶⁴ That raises an issue as to the relevant version to be referred to when determining the meaning of the terms of the treaty. In dealing with this issue, it is important to remember that the model and commentaries form a part of the broader context within which a treaty is interpreted and are only referred to or used in determining the intended meaning of a term rather than to displace the text of the actual convention. Their probative value would ultimately depend on the particular circumstances. It follows that, subject to one qualification, existing double tax agreements may be interpreted in the spirit of the revised commentaries. The qualification being that subsequent amendments to the commentaries should not be used in the interpretation and application of previously concluded conventions where the provisions of those conventions differ in substance from the amended commentaries.⁶⁵

⁶² Above n 50, 344, 349–50, 356–7.

⁶³ For New Zealand see the decision of the Court of Appeal in *CIR v JFP Energy Incorporated* (1990) 14 TRNZ 617, 621. For Canada see the comments of Jean-Marc Dery and David Ward QC, National Reporters for Canada, International Fiscal Association, *Interpretation of Double Taxation Conventions*, Cahiers Volume LXXVIIIa (1993) 278. The Japanese courts have also considered the model to be ‘very important’: Minoru Nakazato, National Reporter for Japan, International Fiscal Association, *Interpretation of Double Taxation Conventions*, Cahiers Volume LXXVIIIa (1993) 415. For a discussion of the UK approach, see J F Avery Jones in Michael Lang (ed), above n 24.

⁶⁴ There are three versions – 1963, 1977 and 1992.

⁶⁵ The OECD Committee on Fiscal Affairs, Model Tax Convention on Income and on Capital, Condensed Version, OECD April 2000, at paragraphs 33–36.

V REFERENCE TO DOMESTIC LAW – STATIC V AMBULATORY

While the general principles of international law govern the interpretation of double tax treaties, those treaties often contain a *lex specialis*, which displaces the generally applicable interpretative rules. Most treaties worldwide contain an article in terms of Article 3(2) of the 1977 OECD Model. That article provides:

As regards the application of the Convention by a Contracting State any term not defined therein shall, unless the context otherwise requires, have the meaning which it has under the law of that State concerning the taxes to which the Convention applies.⁶⁶

In circumstances where the treaty does not provide the necessary definitions and the context does not otherwise require, then the domestic meaning must prevail. In effect, the relieving provisions of the treaty would operate in tandem with the taxing provisions of the internal law and would derive their ambit and practical operation from the internal law.

Where a treaty does not contain an article in terms of article 3(2) of the model, there nevertheless is a strong presumption in favour of the principle that it establishes. US courts have historically taken the view that this interpretative provision is implicit in tax treaties and that the presence of that article provides conclusive evidence of the desire of the treaty signatories to retain their domestic scheme of taxation.⁶⁷ That presumption is based on a general principle of international law that postulates, subject to any unambiguous express or implied limitation prescribed by the treaty, the contracting states must be presumed to have reserved their taxation power. If this principle is accepted, then unless a term is defined in a treaty, the parties must be presumed to permit reference to their respective domestic laws in determining the scope and application of a relieving provision.

In determining the meaning of an undefined term, where a treaty permits recourse to the respective domestic laws of the contracting states, whether by reason of the existence of an express article or by necessary implication, such a term could and often does have a different meaning under the domestic laws of the contracting states. In such circumstances, the divergent meaning attributed to a particular term in a treaty would provide significant scope for either double taxation or double non-taxation and that outcome must, by necessary implication, be consistent with the

⁶⁶ The 1977 model states that the term shall have the meaning which it has under the 'law of that State concerning the taxes ...' whereas the 1963 model uses the words 'laws of that Contracting State relating to the taxes ...'. It appears that the change in expression was not intended to change the import or operation of the article.

⁶⁷ *Samann v Commissioner*, 313 F 2d 461, 462 (1963).

intention and expectations of the parties.⁶⁸ Further, the principle of common interpretation is not applicable to the extent that the contracting states exhibit an intention to apply their potentially divergent domestic laws to the interpretation of a particular term.

One of the more vexed questions raised by the application of Article 3(2) is whether to take a static or ambulatory view of the relevant domestic law to which reference must be made absent a treaty definition and a contrary context. The static/ambulatory dichotomy is a temporal issue that calls for determination whether the convention refers either to the relevant domestic laws as they existed at the time when the treaty was concluded (a static view), or to the domestic laws from time to time in force (an ambulatory or dynamic view). More specifically, whether the reference to the domestic laws extends to all subsequent amendments, whether such amendments result from legislative reform or case law.

Double tax agreements are not made for a single occasion at the time of conclusion but rather for the life of its parties and hence must take into account subsequent developments. In this respect, the application of the terms of the treaty may evolve over time as new things come into existence or become known even though the meaning of the terms may remain constant. The concepts of static and ambulatory are not concerned with changes in the application of a treaty (which change occurs as a matter of course and does not raise that issue) but rather with substantive changes to the content and operation and hence the meaning of the law.

The static view may provide a degree of certainty and consistency in the operation of double tax conventions and would place a constraint on the ability of contracting states to unilaterally change the scope and effect of their international obligations. However, the static view would operate to freeze the law in time and place a significant constraint on the ability of the party states to reform and adapt their domestic laws to global and domestic changes.

The ambulatory approach leaves intact the jurisdiction of the contracting states to modify their taxation laws to reflect changes in policy and approach. It is consistent with the general principle of international law that, subject to any unambiguous express or implied limitation prescribed by the treaty, the contracting states must be presumed to have reserved their taxation power. On this basis, the ambulatory approach provides the practical and legal flexibility necessary to formulate and implement new domestic policies and principles. The powerful

⁶⁸ For a comprehensive examination of Article 3(2) see J F Avery Jones, et al, 'The Interpretation of Tax Treaties With Particular Reference to Article 3(2) of the OECD Model – I' (1984) *British Tax Review* 14; and J F Avery Jones, et al, above n 41, 90.

advantages of the ambulatory view explain why many nations, including Belgium, Germany, the Netherlands, Norway and the United States, have adopted it.⁶⁹

The difficulties with the ambulatory view are illustrated in the Canadian case of *Melford*.⁷⁰ In that case the Supreme Court considered the question whether guarantee fees were interest within the terms of the Canada/Germany Tax Convention 1956. In 1974, the Canadian Income Tax Act was amended such that the payment of a guarantee fee was deemed to be a payment of interest. In effect the amendment sought to extend withholding tax referable to interest to payments by way of guarantee fees.

The court unanimously held that the payment of guarantee fees was not interest and that the amendment to the domestic legislation could not alter the meaning of the word interest in the 1956 convention. Estey J, who delivered the judgement of the court, stated:

Law enacted by Canada to redefine taxation procedures and mechanisms with reference to income not subjected to taxation by the Agreement are not, in my view, incorporated in the expression ‘laws in force’ in Canada as employed by the Agreement. To read this section otherwise would be to feed the argument of the appellant, which in my view is without foundation in law, that subs. (2) authorises Canada or Germany to unilaterally amend the tax Treaty from time to time as their domestic needs may dictate.⁷¹

The Canadian legislature responded swiftly to the *Melford* decision and passed legislation that adopted the ambulatory approach to interpretation.⁷²

⁶⁹ P Baker, above n 16, 38. See also the analysis of this issue at Klaus Vogel et al, above n 12, 64–5; International Fiscal Association, *Interpretation of Double Taxation Conventions*, General Report, Cahiers Volume LXXVIIIa (1993), 80–1; Avery Jones argues that the matter of static or ambulatory is far from settled: J F Avery Jones, et al, above n 68, 40–7.

⁷⁰ *The Queen v Melford Developments Inc* [1982] 2 SCR 504. Note that this case is used for the purpose of illustration rather than stating the current Canadian approach.

⁷¹ *Ibid*, 513.

⁷² Section 3 of the *Income Tax Conventions Interpretation Act 1984* (Cth) provides ‘notwithstanding the provisions of a convention of the Act giving it the force of law in Canada, it is hereby declared that the law of Canada is that, to the extent that a term in the convention is (a) not defined in the convention, (b) not fully defined in the convention, or (c) to be defined by the laws of Canada, that term has, except to the extent that the context otherwise requires, the *meaning it has for the purposes of the Income Tax Act, as amended from time to time, and not the meaning it had for the purposes of the Income Tax Act on the date the convention was entered into or given the force of law in Canada* if, after that date, its meaning for the purpose of the Income Tax act has changed.’ [emphasis added]

In Australia, the question whether the rule corresponding to article 3(2) refers to the domestic law as amended from time to time remains undecided. In its 1975 report, the Asprey Committee made comments that assumed an ambulatory interpretation but did not address the question.⁷³ In *Sherritt Gordon Mines*,⁷⁴ Mason J said:

Whether the reference to the meaning which it has under the laws of that Contracting State meaning that it has under the laws of that Contracting State is ambulatory or static is a serious question. But it is a question which question that I am not disposed to answer.⁷⁵

In a later decision that concerned the interpretation of the Switzerland/Australia double tax convention, that issue did not arise because the term under consideration 'enterprise' did not have an exact counterpart in Australian domestic law.⁷⁶

An ambulatory interpretation has been adopted by the OECD Committee on Fiscal Affairs and forms a part of the model convention and commentaries. Article 3(2) of the 1992 OECD Model provides:

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. [emphasis added]

In other words, the relevant meaning to which reference must be made is the meaning that prevails at the time of application rather than at the time when the treaty was concluded, provided, however, that the context does not require an alternative interpretation.

Where, in the interpretation and application of treaties, an ambulatory approach is adopted in one state and a static approach in the other, the agreed treaty balance of rights and obligations would be disturbed and the state that applies the static approach would be at a comparative disadvantage vis a vis the other. Effectively, one legislature would be free to reformulate domestic laws so as to increase the benefits of existing treaties for its nationals without the other being able to respond in kind.

⁷³ Taxation Review Committee, Full Report, Australia, AGPS 1975, [17.102].

⁷⁴ Above n 23.

⁷⁵ Ibid, 623.

⁷⁶ Above n 50. Nor did the issue arise in *FCT v Lamesa Holdings BV* (1997) 97 ATC 4752. In that case the Full Federal Court considered the interpretation of the Netherlands/Australia double tax convention.

It follows that, subject to the limitations (explained below), in the interest of uniformity and balance between nations it is highly desirable and probable that the ambulatory view would ultimately prevail worldwide.⁷⁷

The adoption of the ambulatory or dynamic approach raises a question as to whether such freedom should be subject to some constraint or limitation upon unilateral action to alter the content, scope or substance of rights and obligations under the treaty. It has been argued that the ambulatory approach must be subject to the implied limitation that its application does not impair the balance or affect the substance of the convention.⁷⁸ Alternatively, the dynamic reference must be subject to the implied limitation that it does not significantly alter the basis of the convention.⁷⁹

The proposed tests to determine the circumstances in which the application of the dynamic approach is permitted are at best vague and fail to disclose a discernible principle that is capable of practical and consistent application. It would be very difficult if not impossible for courts to develop principles that would command international acceptance to determine when a domestic amendment would significantly alter the basis of the convention or would impair the balance or affect the substance of the convention.

The recognition that there would be difficulties in formulating a test in precise and comprehensive terms to constrain the abuse of the ambulatory method does not necessarily mean that such a test is not possible. Courts have in many countries developed principles to deal with abuse in the form of tax avoidance such as business purpose, fiscal nullity, *abus de droit* and *fraus legis*. Whilst the task of developing principles of limitation is a difficult one, it is made far more difficult by

⁷⁷ Vogel and Prokisch have expressed the view that the dynamic (ambulatory) interpretation is not self-evident and added 'following a decision by the Arbitral Tribunal under the London Agreement on German external debts, it is generally accepted in international literature that Article 31(1) VCLT refers to the meaning of that term at the time of signing of the treaty as authoritative. However, the International Court of Justice has, from time to time, also interpreted treaty provisions dynamically': International Fiscal Association, *Interpretation of Double Taxation Conventions*, General Report, Cahiers Volume LXXVIIIa (1993), 80. It is submitted that there is nothing in the terms of Article 31(1) of the Vienna Convention to justify a static view. In fact the mandatory requirement that the treaty shall be interpreted in 'good faith' may be taken to endorse a dynamic interpretation constrained by the requirement of 'good faith' and by the context, object and purpose of the treaty.

⁷⁸ John F Avery Jones, et al, above n 68, 48.

⁷⁹ The general reporters considered that this implied limitation was demanded by many national reporters in International Fiscal Association, *Interpretation of Double Taxation Conventions*, General Report, Cahiers Volume LXXVIIIa, (1993) 80.

the need for international uniformity or consistency. Absence of such uniformity in approach as to what constitutes the relevant treaty abuse or impermissible conduct would undermine the treaty balance of rights and obligations in the same way as the application of the static approach in one state and the ambulatory in the other in the interpretation of a treaty. It follows that such an implied limitation is impractical and unnecessary.

The primary limitation imposed on the potential abuse of the ambulatory approach is contained in the interpretative rules of the Vienna Convention and the terms of article 3(2) of the model convention — if adopted. A change in domestic law would only determine the meaning of terms that are not defined in the treaty to the extent that such a change is consistent with the context, object and purpose of the treaty. To the extent that the context, purpose and object fail to operate as a comprehensive limitation, there is always the practical constraint that the other contracting state can respond in kind thereby undermining the whole basis of the treaty. This issue does not arise where a treaty expressly permits recourse to the relevant domestic meaning that prevails at the time of application because such an express term would indicate that a change in domestic law would be consistent with the intention and expectations of the parties.

VI CONCLUSIONS

Double tax conventions have played a significant role in promoting free trade and investment and have placed a constraint on harmful tax practices by encouraging greater dialogue, awareness and understanding of other nations.

Divergence in the interpretation of double tax conventions can have substantive differences in result thereby undermining the primary objectives of double tax conventions. The OECD Model Convention and Commentaries and the Vienna Convention have played a major role in promoting greater consistency in the interpretation of double tax conventions by national courts. Further, it is encouraging to see that domestic courts are more willing to look to overseas experiences and approaches in formulating their views as to the meaning and application of treaty terms.

The gradual integration of global economies and increased exposure to other cultures will inevitably operate as a powerful force towards greater harmonisation of taxation systems and uniformity in the interpretation of taxation conventions. If the world breaks up into free trade blocks, then it is highly probable that each trade block would strive to develop a block double tax agreement. That does not necessarily result in divergence in the nature and content of double tax conventions, as that would ultimately depend on whether the break up of the global economy results in trade war.

Despite the diversity of taxation systems and economic systems within which they operate, it is true to say that in general the actual approaches adopted to the interpretation and application of double tax conventions are conceptually comparable and that substantive differences are often a matter of impression and degree. Over the years there emerged a common theme characterised by convergence of principle and approach in the interpretation of double tax conventions. In the long term, it is reasonably likely that the forces of globalisation would prove to be a powerful force towards greater harmonisation of taxation systems and uniformity in approach to the interpretation and application of double tax conventions.