Using the OECD Model Commentaries and Other Tools to Interpret Tax Treaties

by Christos A. Theophilou

Christos A. Theophilou is an international tax and transfer pricing partner at Taxatelier Ltd. and based in Cyprus. Email: ctheophilou@taxatelier.com

In this article, the author discusses the interpretation of tax treaties and the use of internal and external tools as interpretive aids. In particular, he considers whether it is appropriate to rely on the commentaries to the OECD model income tax treaty as an external tool and examines the availability of established internal aids for treaty interpretation.

The interpretation of tax treaties and double tax agreements in particular is an essential, but nonetheless controversial, part of the international tax arena. This article examines the difficulties that arise when using specific interpretive tools to arrive at the meaning of contested tax treaty language and assesses whether those difficulties should affect the weight given to those sources.

In particular, this article considers whether the commentaries on the articles of the OECD Model Tax Convention on Income and on Capital1 are a legally valid external interpretive tool. The analysis also considers the availability of internal tools for treaty interpretation. Ultimately, the article cautions readers about the uncertain legal status of the commentaries and suggests that recent events may help strengthen internal means of interpretation.

I. Means of Tax Treaty Interpretation

DTAs are bilateral contracts between two states. It is therefore essential that those applying the agreements follow the relevant domestic courts’ guidance when interpreting conflicting clauses. Usually, the preamble of a DTA recites its purpose as something akin to “the avoidance of double taxation and prevention of fiscal tax evasion.”2 Further, it is important to recognize that a DTA is an international agreement that incorporates the domestic laws of multiple jurisdictions, which may have different interpretations of the same provision. In particular, some states — known as monistic states — treat DTAs as superior to prior or subsequent domestic legislation, while other states follow the so-called dualistic model and attribute superior status to a DTA only after the domestic legislature approves the instrument.3

In their adjudicating capacity, the domestic courts of each treaty state will provide the definitive answers on issues of tax treaty interpretation.4 The United Kingdom’s approach to treaty interpretation is reflected in the leading case of Inland Revenue Commissioners v. Commerzbank, [1990] STC 285, 297 (U.K.), a ruling that the Court of Appeal later endorsed in Memec PLC v. Inland Revenue Commissioners, [1998] STC 1336 (U.K.).

1 Unless otherwise specified, references to the OECD model are to the 2017 version.


Under the United Kingdom’s common law tradition, a literal approach to interpreting an international treaty is inappropriate. Instead, U.K. courts often elect for a purposive approach. Reflecting that approach, the Commerzbank court reasoned that because the treaty was not prepared by English drafters, it should be interpreted using broad, generally accepted principles. DTAs, the court concluded, should principally be interpreted based on the Vienna Convention on the Law of Treaties (VCLT), which opened for signature in 1969, entered into force in 1980, and has been ratified by 114 states. In particular, the court focused on the general rules of interpretation in article 31 and article 32, which discuss supplementary means of interpretation. Notably, the Commerzbank court stated that:

subsequent commentaries on a convention or treaty have persuasive value only, depending on the cogency of their reasoning. Similarly, decisions of foreign courts on the interpretation of a convention or treaty text depend, for their authority, on the reputation and status of the court in question.

The court did set a bit of a limit to its broad endorsement of the VCLT, suggesting that supplementary aids could be used in tax treaty interpretation but are not mandatory.

Courts in many other states — including Canada, India, South Africa, and the United States — follow an approach similar to that used in the United Kingdom.\(^5\)

As the Commerzbank judgment demonstrates, the VCLT is an indispensable aid to courts. Specifically, article 31 codifies the principles of international tax law regarding treaty interpretation.\(^6\) Article 32 serves as a supplementary tool for use when a treaty’s meaning cannot be determined by restricting oneself to the interpretive rules of article 31. Further, article 33 provides guidance for resolving issues of interpretation when the parties have authenticated a treaty in two or more languages.

The VCLT instructs those attempting to interpret tax treaty terms to begin by considering the terms in their common usage context — that is, taking the terms at face value. Specifically, article 31(a) states:

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.

Second, one may refer to the terms within the context of the DTA itself, which requires considering the principles of international tax governance and the meaning given to the relevant terms by the legal jurisprudence of the contracting states.\(^7\) Thus, the following sections will first examine external aids to treaty interpretation — in particular, the OECD model commentary — and then internal aids of interpretation, such as the articles of the OECD model.

II. Legal Status of the Commentaries

A. Existing Commentary (at the Time of Signing)

The OECD commentaries are highly valued in practice as a tool for treaty interpretation, despite the fact that — as paragraph 29 of the introduction to the model treaty and the commentaries notes — they are not a legally binding document. Indeed, an increasingly wide range of courts have accepted the commentaries, including courts in OECD member states (for example, in the application of the Ivory Coast-Norway income tax treaty) as well as courts in non-OECD member states that have published their positions on the OECD model and its commentaries (for example, the Indian Income Tax Appellate Tribunal in Metchem Canada Inc. v. Deputy Commissioner of Income Tax, [2006] 100 ITD 251 (MUM.)).

Regarding the use of public international law, the commentary does not explicitly refer to the VCLT. Therefore, courts rely on inference to justify their use of the principles of articles 31 and 32 VCLT when deciding cases. For example, courts reason that when both OECD member states and nonmember states bilaterally conclude


DTAs, they have tacitly agreed to the VCLT using article 31(2)(a). Furthermore, as one scholar explains,’ courts have justified “recourse to the non-binding normative environment of a treaty” under article 31(3)(c),

Alternatively, article 31(4) VCLT potentially applies based on the “parties so intended” language, assuming this was the intention of the parties during the conclusion of the DTA. This position is suggested in Trevor Smallwood Trust v. Revenue & Customs, [2008] UKSPC SPC00669 (U.K. Special Commissioners), which interprets the Mauritius-U.K. treaty. Finally, as a last resort in terms of guidance from the VCLT, if article 31 fails to apply then national courts could also cite article 32.

In regards to OECD member countries and non-member countries that have published their position regarding the OECD model commentaries, one could argue that the commentaries are tacitly binding based on the principles of estoppel and acquiescence, in particular when such a country refrains from making an observation on them. As a result, some may argue that such a state has tacitly accepted the commentaries by publishing their position in this respect. However, other academics contend that some paragraphs of the VCLT do not encompass the commentary, and they do not refer to the principles of estoppel and acquiescence. Consequently, some may argue that courts of OECD member states and nonmember states will follow the commentary in existence at the time the parties signed a given treaty as this was so intended or implicitly agreed. However, if a party to a DTA has not provided any observations on the commentary or if the articles of the DTA do not follow the OECD model, then it will be more difficult to argue that a national court should follow the commentary.

B. Later Commentaries

For two reasons, the situation becomes more problematic when it involves the adoption of later versions of the commentary. To begin with, because the later commentaries may be based on different wording in the articles of the OECD model — that is, articles that the two states never actually signed — the courts may be unwilling to follow the commentaries since the relevant articles were never approved by that state’s government. Second, courts will find relying on the VCLT to be more complicated since the states did not negotiate any subsequent commentaries bilaterally, making it difficult to argue that there is any subsequent agreement.

The OECD itself essentially advocates for the so-called ambulatory approach to this issue — that is, that one should consult the most recent version of a given source of interpretation. Specifically, paragraphs 33 to 36.1 of the introduction to the model treaty and the commentaries encourage both tax authorities and taxpayers to consider the latest version of the OECD model and its commentaries as the relevant point of inquiry when interpreting the treaties. On the other hand, the OECD rejects the \textit{a contrario} interpretation of new articles of the OECD model and their commentaries, arguing that changes may not result in different principles from the previous versions but instead may simply be additional clarifications that do not significantly change the meaning of the previous text. For instance, the Finnish Supreme Court referred to later commentaries for the definition of royalties since the older commentary from 1977 did not include software in the definition of royalties. As a result, the Court followed the later commentary.

In contrast with the OECD’s position, some courts opt not to follow any newly revised articles, reasoning that the revised or new language had not been enacted as a law in that

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11. See Jones, supra note 2, at 5.2.5.


14. Jones, supra note 2, at 5.2.3.2.

15. Jones, supra note 2, at 5.3.4.
state, for example, appropriate parliamentary procedure. This may be the case, for instance, with the new wording added to article 7 (business profits) of the OECD model in 2010 — a substantial change from the previous wording of article 7. Article 7 of the pre-2010 OECD model included seven paragraphs while the newer version includes only four. Paragraphs 2-6 were deleted from the pre-2010 version of article 7 and another two new paragraphs were added to form the existing version of article 7 of the OECD model. In particular, the new version considers a permanent establishment to be a separate and independent enterprise and holds that the arm’s-length principle needs to be applied based on the approach adopted in the OECD’s 2010 “Report on the Attribution of Profits to Permanent Establishments.”

One can argue that the DTA negotiators might have thought that the DTA would change in later years; however, it is problematic to argue that substantial amendments might have been in the “negotiators’ minds” when they concluded the DTA. This is most obvious when many years have passed, such as when some argued that the language of a 2010 OECD report was relevant to understanding the meaning of a treaty concluded in 2000. To anticipate this problem, countries typically include wording in their DTAs stating that later commentaries may, at least in some circumstances, be relied upon. Several DTAs negotiated by Austria, for example, include such language.

In summary, when treaty language standing alone does not provide answers regarding the interpretation of tax treaties, courts will rely on articles 31 and 32 VCLT to justify an evolutive interpretation of a treaty provision. This is highlighted in the International Court of Justice case Navigational and Related Rights (Costa Rica v. Nicaragua) (July 13, 2009). As the Court states in that case, while meaning must be restricted in line with the parties’ intentions and interests, the parties may have intended for the meaning to evolve.

This position is also reflected in Taisei Fire and Marine Insurance v. Commissioner, 104 T.C. 535 (1995). In that case, the U.S. Tax Court consulted the wording of the 1977 commentary to interpret a DTA signed in 1971. The court reasoned that the seemingly more relevant treaty commentary issued in 1963 was in fact flawed, and the parties expressed their real intention in the 1977 commentary. Hence, the court found that the 1977 commentary should apply, even if it “contradicts the literal language of the commentary in effect at the time of ratification.”

However, many courts do not accept later commentaries, a position reflected in decisions issued by courts in Denmark, France, and Spain. Nevertheless, the U.S. Tax Court is also not necessarily a lone outlier. A court in the United Kingdom also considered later commentaries in the aforementioned Trevor Smallwood Trust case, when John Avery Jones said, “The safer option is to read the later commentary and then decide in light of its content what weight should be given to it.”

III. Internal Aids to Interpretation

A. Article 3, Paragraph 2 of the OECD Model

In accordance with article 3(2) of the OECD model, undefined terms included in a DTA (for example, profits or income) are defined and interpreted by the domestic law of the state to which they apply “unless the context otherwise requires.”

1. Applying an Ambulatory Approach

One very controversial issue that is relevant to this article is one of timing: When interpreting a tax treaty, do you interpret it based on the law as it stood at the time the treaty was signed or the law as it stood when the dispute arose?

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16 Erasmus-Koen and Douma, supra note 12, at 341.
17 Becerra, supra note 7.
18 See also Michael Edwardes-Ker, Tax Treaty Interpretation, chapter 29 (1994).
This issue arose in *The Queen v. Melford Developments Inc.*, [1982] 2 SCR 504 (Can.). The case involved a payment that the Canadian tax authorities considered interest, and they sought to impose a 15 percent withholding tax. The taxpayer, however, claimed the payment was business profits. Therefore, the taxpayer argued that since it did not have a PE in Canada, the relevant entity was not liable to tax there. The Supreme Court of Canada considered whether it should interpret the treaty based on the domestic law as it existed in 1954 when the Canada-Germany DTA was signed (that is, using the so-called static approach) or based on domestic law in force during the tax year at issue (the so-called ambulatory, or dynamic, approach). The Court opted to use the ambulatory approach and ruled in favor of the taxpayer.

In 1995 the OECD amended the wording of article 3(2) to include the phrase “at that time.” As paragraph 11 of the commentary to article 3(2) explains, this change explicitly favored defining terms that are not defined in the DTA based on the law “in force when the Convention is being applied, i.e. when the tax is imposed.” Thus, the amendment endorsed the ambulatory approach.

A U.K. tax court also followed the ambulatory approach in *Fowler v. HM Revenue & Customs*, [2016] UKFTT 234 (TC), with the court noting that it was proper to do so as long as the contracting state enacted the change in good faith and the law did not attempt to change the distributive rules of the DTA “in such a way as to reallocate income from one article to another . . . [since] that could contravene the requirements of good faith.”

However, the OECD’s action in 1995 does not completely settle the issue since many treaties still include the older wording.

The OECD hopes to address this issue through the multilateral instrument, which entered into force July 1, 2018. To date, 89 jurisdictions have signed the MLI. The MLI includes various provisions about the interpretation of DTAs, including article 2, paragraph 2, which is similar to the revised article 3(2) of the OECD model.

2. Referencing Definitions in Domestic Law

Additional interpretation issues arise from the rule that the domestic law meaning of a treaty term is to be used to define terms that are not defined by the DTA itself “unless the context otherwise requires.” There are three key issues to consider here.\(^24\)

First, what does the term “context” mean? This is a very broad concept that includes both article 3 of the OECD model and article 31(2) VCLT.\(^25\) Notably, the OECD model\(^26\) tends to apply a narrower definition of context than that supported by the language of the VCLT.

Second, if a domestic law definition exists, how solid and appropriate is this definition? Will it satisfy the context requirement?

Finally, if the definition in domestic law is inappropriate or does not exist, then what definition is appropriate?

Consider, for instance, the U.K. case of *Indofood International Finance Ltd. v. JPMorgan Chase Bank NA, London Branch*, [2006] EWCA Civ 158. While a definition of the contested term “beneficial owner” existed in the United Kingdom’s domestic law, the court declined to apply what it deemed an overly technical domestic law meaning and instead relied on an “international fiscal meaning.”

3. Which Domestic Laws?

Further, a question sometimes arises in the context of article 3(2) of the OECD model regarding which internal law of the applicant country should apply — that is, all applicable laws or only applicable tax laws? To address this, as paragraph 13.1 to the commentary on article 3 explains, the OECD amended article 3(2) in 1995 to clarify that the definitions found in applicable tax laws are preferred to definitions in nontax domestic laws. However, difficulties still remain, as there are treaties that do not include this provision.

\(^{23}\) See articles 31 and 26 VCLT and the general principle of *pacta sunt servanda*, which dictates that agreements must be kept.

\(^{24}\) Baker, *supra* note 5, at 38.

\(^{25}\) Jones, *supra* note 2, at 8.1.

\(^{26}\) Commentary to article 3 of the OECD model, para. 12.
B. Conflicts of Qualifications and MAP

Another interpretation issue may arise when the principles that apply to the interpretation of domestic tax law conflict with those of international tax treaties, thereby causing conflicts of qualification such as occurred in the Melford case discussed above. This issue can be, and most commonly is, resolved with the resident state accepting the treatment and qualification proposed by the source state.\(^\text{27}\) In 2000 the OECD amended the commentary to favor the source state approach.\(^\text{28}\) Consistent with that approach, the OECD also introduced a new paragraph 4 in both articles 23A and 23B.

Conflicts of qualification can also be resolved using the mutual agreement procedure found in article 25, paragraph 3 of the current OECD model. However, that article provides that the states shall “endeavour” to resolve the dispute using the MAP — which paragraph 27 of the commentary on article 25 notes does not mean they must actually resolve the issue in question. Consider the U.S. case of Pierre Boulez v. Commissioner, 83 T.C. 584 (1984). The IRS claimed jurisdiction to tax Pierre Boulez, a German orchestra conductor, for earnings arising from his activities in the United States based on the theory that those activities constituted the performance of personal services. German tax authorities argued that the payments Boulez received were royalties, and thus subject to tax in Germany only. The competent authorities of the two states engaged in a MAP but failed to agree.

Notably, even if the competent authorities did reach an agreement, the agreement may not have been legally binding on the courts of the two jurisdictions. The argument against MAPs binding courts is that they lack democratic approval and do not allow taxpayers to protect themselves from wrongful agreements.\(^\text{29}\) Nevertheless, in a U.K. case, Ben Nevis (Holdings) Ltd v. HMRC, [2013] EWCA Civ 578, the court viewed this differently and concluded that an agreement between HMRC and the South African Revenue Service regarding the collection of foreign revenue claim in the United Kingdom was retrospectively valid.

The OECD addressed this issue in 2008 by introducing an arbitration clause as article 25, paragraph 5 of the model treaty. Nonetheless, few treaties contain this clause at present. However, the OECD included several articles in the MLI intended to improve the MAP and the arbitration process — specifically, articles 16-26, which form Part V (titled “Improving Dispute Resolution” and including the MAP) and Part VI (titled “Arbitration”) of the MLI. States signing the MLI will automatically include an arbitration clause in their covered DTAs, and the new procedure is expected to be more efficient than its predecessor.

IV. Conclusion

In conclusion, the commentaries are routinely used by national courts when they are interpreting a DTA. And they rely on them whether or not they refer to the VCLT, and whether or not the commentaries are considered legally binding from the standpoint of domestic legislation or in the eyes of the OECD.

Ultimately, tax authorities and taxpayers should approach commentaries issued before (or contemporaneously with) the enactment of a given treaty with caution. They should also recognize that commentaries issued or amended after the enactment of a treaty appear more problematic. The safer option, as Jones advises, is to “read [the relevant commentary] and then decide in the light of its content what weight should be given to it.”\(^\text{30}\)

As a final note, readers should remember that because the OECD regularly updates or otherwise changes the model language and given the ongoing and widespread implementation of the MLI, internal means of interpretation are always the safest starting point when undertaking treaty interpretation.