

Taxation and Interpretation

Marco Greggi

Visiting Research Fellow at China University of Political Sciences and Law

Academic Year 2022 - 2023

Lesson 03



Programme of the Day 03

1. Issue of interpretation in Law and in Taxation;
2. International law and Interpretation: ways and means;
3. The case for International Taxation and the Tax Treaty Models:
 - a. The OECD Model Convention(s);
 - b. The OECD Commentary;
 - c. The UN Model Convention.



Interpretation and the Law

- Interpretation of the Law: as law is language, interpretation is the extraction of the meaning from the text, adapting a general rule to a specific behaviour in real life;
- Kind of extraction:
- Linguistic interpretation;
 - Particularly significant in the case of multi-lingual texts
- Legal interpretation;
 - Addressing technical concepts or common concepts used to convey a technical (i.e. legal) meaning.



The Actors on the Scene

- Interpretation is an activity engaging multiple subject, including:
 - The laymen on the streets;
 - The Public administration and people of the public sector;
 - The executive power is supposed to operate consistently with the rule of law;
 - The Judiciary;
 - From Law in books to law in action;
 - Academics;
 - Soft interpretation.





The Letter and the Purpose

- Literal interpretation:
 - Understand and apply the law as it is written in the text, no more, no less;
- Purposive interpretation:
 - Try and figure out the purpose of the provision and apply it accordingly even to extent which are not clearly covered by the letter of it.
- In Taxation reserve of law should favour Literal Interpretation as a sort of protection of taxpayers' rights ...



Interpretation: Tips and Income

- Suppose that income from labour must be taxed ...
 - What about Tips ?
- Literal:
 - A tip is not salary;
- Purposive:
 - A tip is earning for the waiter, so it should be reported and taxed accordingly ...





International law and Interpretation

- Interpretation should bridge between different legal cultures, including:
 1. Language;
 2. Constitutional principles;
 3. Legal systems of the case;
 4. Customary approaches and tradition as enforced by the Judiciary;
- Complex scenario for the interpreter while dealing with (tax) treaties and international agreements.

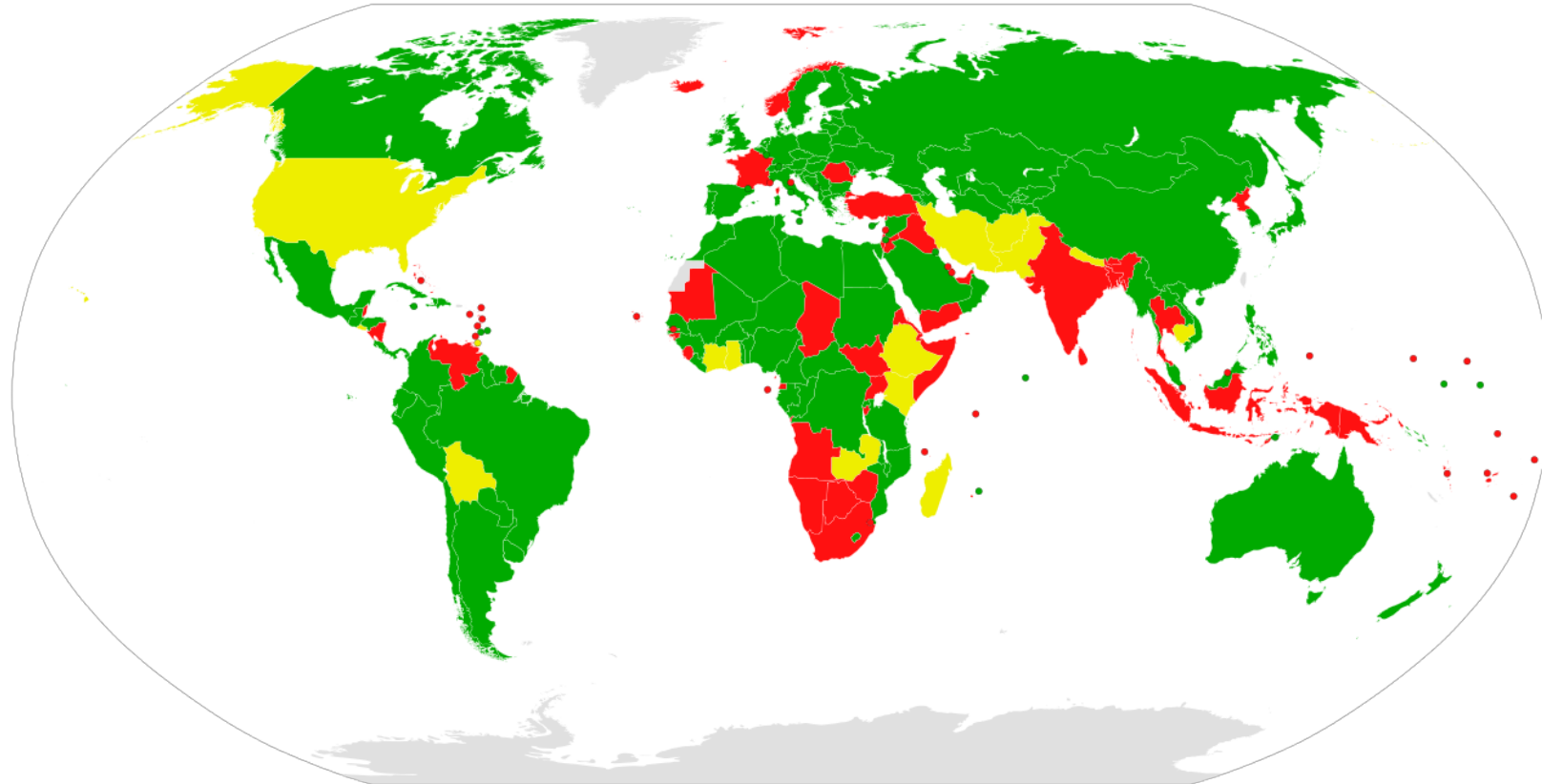


Introducing the Vienna Convention

- Vienna Convention on the Law of Treaties (VCLT) 1969 is an **essential element** to interpret International Agreements (in the field of taxation too);
- Your approach as a (perspective) practitioner:
 - Verify whether the other Country is part of the Vienna convention or not:
 1. **Yes, it is:** the VCLT is therefore a legal instrument to interpret the treaty (this is the Chinese situation);
 2. **No, it is not:** the VCLT may nonetheless be used by domestic court like a *persuasive* element (in the USA, for instance, the situation is like this).



How far goes the Vienna Convention ?



Applicable – Signed (not yet applicable) – Not signed



The Text of the Convention

- Article 31 (1):
 - A Treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their **context** and in the **light of its object and purpose**;
- Article 31 (2):
 - The context for the purpose of the interpretation of a treaty shall comprise, in addition to the **text**, including its preamble and annexes:
 - a. **Any agreement relating to the treaty** which was made between all the parties in connection with the conclusion of the treaty;
 - b. **Any instrument which was made by one or more parties in connection with the conclusion of the treaty** and accepted by the other parties as an instrument related to the treaty.



Continued ...

- Article 31 (3):
 - There shall be taken into account, **together with the context**:
 - a. Any **subsequent agreement** between the parties regarding the interpretation of the treaty or the application of its provisions;
 - b. Any **subsequent practice** in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
 - c. Any **relevant rules of international law** applicable in the relations between the parties.
- Article 31 (4):
 - A special meaning shall be given to a term if it is established that the parties so intended.



Supplementary Means of Interpretation

- Article 32 (Supplementary means of interpretation):
 - Recourse may be had to **supplementary means of interpretation**, including the **preparatory work** of the treaty and the **circumstances of its conclusion**, in order to confirm the meaning resulting from the application of 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.



From Law to Taxation

- Vienna convention applicable to International taxation, domestic judiciary should consider it;
- Specific weaknesses to be considered:
- Lack of supra national jurisdiction (plenty of arbitration panels, but no judiciary);
- Lack of means to deal with conflict of qualifications (when parties disagree with a concept).



René Magritte, Belgian surrealist Painter (1898 - 1967) – «*The Treachery of Images*»



What is a Tax Treaty ?

- Tax Treaties, or Double Tax treaties, or Double Tax Conventions;
 - Unless otherwise specified, they are to be intended as synonyms (*they are same*) when used in academic writings or in literature;
- Why “Double Tax” Treaty ?
 - Goal of the Treaty:
 - Prevent double taxation;
 - More recently: prevent tax avoidance, that is minimise the risk of revenue loss due to the unfair behaviour of the taxpayer who could try and hide his taxable base elsewhere.
- In theory any tax could be covered by a treaty;
- In practice treaties deal with Income (occasionally with wealth).



Function of the Treaty

- Minimize (possibly, remove) juridical double taxation on cross border income;
 - **Juridical double taxation:** the same person is taxed twice in two different States (or more);
 - **Economical double taxation:** the same income (asset) is taxed twice in two different States (or more) on two different taxpayers (or more);
- Basically, Treaties (Double Taxation Conventions – DTC, from now on) deals with juridical double taxation, and occasionally with economical one.



Making Sense of the Distinction



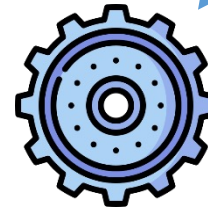
1



Canadian businessman does an occasional work in China and receives a payment there.



1



2



Chinese company operates in China and makes profits there, which are taxed in China. Once profits are taxed, the remaining part (Profits – Tax) is distributed to shareholders. One of the shareholders is in Canada



Tax Treaties and Source of Law

- The effects of DTC depend on domestic law and on the hierarchy of the Sources of law;
- Most of the cases: Treaties are directly applicable and override domestic rules in conflict with them;
- Different approaches may be possible:
 - US: Treaties are equivalent to the Act passed by the Congress, no specific formality to repeal them;
 - China: Treaties may be overridden by Circular letters of the Ministry of Finance. Is it so ?



Treaties and Models

- Every Treaty is **Bilateral**, every Treaty is a **point-to-point legal relation**;
- In practice:
 1. Treaties are written starting from some blueprints (templates), the Model Tax Conventions;
 2. Negotiations occurs when parties want to diverge from the template;
- Core issues:
 1. Models differ from each other in attributing more (or less) importance to nexuses, in particular to source of income;
 2. Models proposed by developing countries (Capital importers) tend to give more taxing powers to the source States.



The *De facto* Standards

OECD Model Convention



Latest release on November 2017

UN Model Convention



Latest full release in 2017



Are there Differences ?

- OECD:
 - Mostly in favour of the residence Country, that is, the capital exporter Country
- UN:
 - Mostly in favour of the source Country, that is, the capital importer Country





Concluding Remarks

- Interpretation is **crucial activity** in the application of Tax treaties and for Tax Planning as well;
- In doing cross border consultancy it is essential to familiarize with the other State's discipline and realize that the understanding of concepts might **diverge**;
- Consequences:
 1. Conflict of qualification;
 2. Possible (very likely) double taxation;
 3. No Court to appeal to for the proper interpretation of the Treaties ...
 4. ... increase of costs for the client / the company you will work for.



The OECD way to deal with Interpretation

- Chapter II of the Double taxation convention (OECD inspired):
- Art. 3. General definitions.
 - In this Convention, unless the context otherwise requires:
 - ... *omissis* ...
 - 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 laws of that Contracting State concerning the taxes to which the Convention applies.
- Domestic law is essential in the interpretation of Treaties.



End of Lesson 03

- Suggested reading (B, elective): E. Reimer, *Interpretation of Tax Treaties*, European Taxation, 1999, pages 458 - 474.