The Multiple Amendment of Bilateral Double Taxation Conventions

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1. INTRODUCTION

One of the problems which comes with success is how to improve upon it. By any measure, the OECD Model Tax Convention on Income and on Capital is phenomenally successful. In slightly over 40 years since its first draft was published, more than 2,000 double taxation conventions (DTCs) have been concluded, most of them based on the OECD Model or its offshoot, the United Nations Model Double Taxation Convention between Developed and Developing Countries. Being "based on" the OECD or UN Model means that, in most of these DTCs, 90% or more of the text of the DTC follows exactly the wording of the OECD or UN Model. The pattern of bilateral DTCs, concluded between pairs of states for the purpose of coordinating their tax systems, is itself a reflection of the approach endorsed by the OECD.

But with this success comes a major problem: how to improve upon the wording that has become standard in so many individual bilateral DTCs. What if the standard "boilerplate" wording, which constitutes 90% or more of the wording of these DTCs, has become inadequate or out of date or simply merits improvement? One of the most pressing problems in international tax practice at the present time is how to devise a simple system – consistent with the bilateral nature of existing DTCs and the constitutional traditions of the many countries concerned – for amending the wording of large numbers of bilateral DTCs in a short period of time.

The traditional method of updating and amending bilateral DTCs has been the conclusion of an amending protocol between the two contracting states. That method is always available if the two states wish to change the wording of the DTC, not because of any fundamental issue between them, but simply because the OECD Model boilerplate needs updating. The negotiation of large numbers of bilateral protocols, however, is time-consuming, and it runs the risk that one or both contracting states may wish to open up other issues during the negotiations which can delay or even terminate the process. In addition, in countries that have a parliamentary procedure for the approval of DTCs and their protocols, in principle each protocol must be taken separately through this procedure.

The United Kingdom, for example, has more than 100 comprehensive DTCs in force. Amending these DTCs, even if only to reflect changes in the OECD Model, would require an enormous effort in negotiations. In addition, each protocol concluded would need to be taken through the scrutiny committee in Parliament by a separate Order in Council. More realistically, if the United Kingdom decided to update the wording of its existing DTCs, this is likely to form part of the general process of updating the UK's DTC network; based on present practice, it would take 15 to 20 years before most of the network was updated to reflect the new form of words.

2. AMENDMENTS TO THE OECD COMMENTARIES

In light of the difficulty in amending large numbers of bilateral DTCs, the OECD's preferred approach in recent years has been to make few amendments to the articles of the OECD Model itself.[1] Instead, the OECD's preferred approach has been to amend the Commentaries, which were adopted alongside the OECD Model. As a result, the Commentaries have been amended – sometimes to major extent – on average every two years over the last decade.

Amending the Commentaries, however, is far from an adequate solution to the updating of the texts of DTCs themselves. There are several problems with this approach. First, the exact status of the Commentaries remains unclear as a matter of international law, though courts in a growing number of countries have referred to the Commentaries as an aid to interpretation. There is a view, however, that the more frequently the OECD amends the Commentaries, the less authority the Commentaries have. Even if a court is willing to refer to the Commentaries, the wording of the Commentaries cannot alter or override the clear wording of the articles of a specific DTC. Frequent amendment also makes it difficult to determine exactly what was the wording of the Commentaries at a particular time. Major doubts remain as to whether amendments to the Commentaries can have any impact on DTCs concluded prior to the amendments or to tax years prior to the amendments.[2] In some cases, the amendments to the Commentaries state that they merely clarify a pre-existing view adopted by the OECD Member countries. Even where this is stated, it cannot be certain that a court will accept the amended Commentaries as a reflection of the pre-existing meaning. Since amendments to the Commentaries are published after approval by the OECD Committee on Fiscal Affairs (CFA) and by the Council of the OECD, the exact date on which an amendment to the Commen-

1. For example, the 2005 update to the OECD Model makes amendments to Art. 19 (Government service) and Art. 26 (Exchange of information) and a minor amendment to the French text of Art. 15 (Income from employment), but otherwise leaves the OECD Model unchanged. At the same time, the amendments to the Commentaries are extensive.

2. See, for example, Lang, M., "Later Commentaries of the OECD Committee on Fiscal Affairs ...", *Intertax* (1997), at 7. See also Avery Jones, John F., "The Effect of Changes in the OECD Commentaries after a Treaty is Concluded", 56 *Bulletin for International Fiscal Documentation* 3 (2002), at 102 (summarizing the discussion in the OECD/IFA seminar at the IFA Congress in 2001).

taries was made may be difficult to determine and is unlikely to coincide with the beginning or end of a tax year in particular states.

For a whole variety of reasons, therefore, amending the OECD Commentaries is not a substitute for amending the articles of the OECD Model itself where what is really needed is a change to the wording of the articles. Correlatively, where change is needed, there is no substitute for amending the actual terms of specific DTCs between pairs of contracting states.

3. EXAMPLES OF THE NEED TO CHANGE THE WORDING OF ARTICLES OF DTCs

It may be helpful to give some examples of instances where it would be desirable to change the wording of the articles of specific DTCs and where amending the OECD Commentaries would not suffice.

A simple example is where the articles of the OECD Model are themselves amended. For example, the July 2005 version of the OECD Model contains a number of amendments to Art. 26 on the exchange of information. These amendments were prepared by Working Party No. 1 and approved by the CFA and the Council of the OECD. Though Austria, Switzerland, Belgium and Luxembourg have made reservations on Art. 26, the vast majority of the OECD Member countries clearly accept the new wording of Art. 26. Assuming that each of these countries adopts the new wording for future treaty negotiations, it will take decades before the new wording is reflected in the majority of DTCs in force.

A second example where it would be helpful to have a method for the rapid amendment of large numbers of DTCs is where translation errors come to light. A recent project on the translation of the OECD Model into Spanish and Italian identified a not insignificant number of occasions where the existing texts of DTCs in those languages do not accurately reflect the English and French texts of the OECD Model, even though the Spanish and Italian texts were intended to do so. Where a project like this identifies a number of errors in translation, it would be helpful to have a simple and rapid system for bringing all those language versions into line with the versions adopted by the OECD.

An extremely good example of the need for a method to amend the wording of large numbers of DTCs is the current work of the OECD on the attribution of profits to permanent establishments.[3] This work was, quite expressly,[4] not constrained by the existing wording of Art. 7 of the OECD Model. The Working Party determined the most appropriate approach to the attribution of profits, even though that approach might not be consistent with the existing wording of the OECD Model.

As the work progressed, views have varied as to whether implementation of the authorized OECD approach would require amending the wording of Art. 7, whether it could be achieved simply by amending the Commentary on Art. 7, or whether an alternative approach might be needed. At the very least, most people accept that, if the OECD adopts the authorized approach as the only correct approach to the attribution of profits and no changes are made to the wording of Art. 7, there will be a period of substantial uncertainty in many countries before it becomes clear whether or not the courts of that country will accept that the authorized approach is consistent with the wording of existing articles based on Art. 7.

Because there have been few amendments to Art. 7 since it was first published in 1963, the vast majority of DTCs currently in force contain wording similar to that in Art. 7. In particular, virtually all contain reference to the "separate enterprise" concept. How attractive it would be if any uncertainty could be removed by amending all, or virtually all, the business profits articles in existing DTCs by introducing wording that clearly supports the authorized approach. At present, however, there is no method for achieving this, and a highly unsatisfactory period of uncertainty may be the outcome. In the final analysis, the courts in some countries are likely to find that the authorized approach is not consistent with the existing wording of Art. 7, and even greater disparity between the practice of states will have resulted.

A final example where it would be useful to have a method for amending large numbers of existing DTCs in a single and rapid process has arisen within the European Union. Though at present the issue is under debate, increasingly views are being expressed that the existing DTCs between the 25 EU Member States may need to be amended to bring the DTCs into conformity with Community law. Exactly what, if any, changes are needed may become clearer over the next few years. To take one example: suppose that it becomes clear – e.g. as a result of a decision of the European Court of Justice – that the articles of all existing DTCs dealing with associated enterprises and with the mutual agreement procedure need to be amended to ensure conformity with the 1990 Arbitration Convention.[5] One suggestion that has been mooted is for the European Commission to prepare a form of words which could be adopted by the Member States in their DTCs. The question then arises as to how this wording might be incorporated into existing DTCs. Again, a simple and rapid process for amending multiple bilateral DTCs would be highly desirable.

4. SOME POSSIBLE SOLUTIONS TO THE PROBLEM

One possible solution to the problem of multiple amendments of bilateral DTCs is for the CFA, when it adopts an amendment to an article of the OECD Model, to also adopt a standard form protocol that a pair of states could conclude in order to incorporate the amendment into their existing bilateral DTC. This has the attraction that it preserves the essentially bilateral nature of DTCs, particularly given that some governments seem averse towards any move which suggests a growth of multilateral agreements in the direct tax area.

3. See OECD, *Discussion Draft on the Attribution of Profits to Permanent Establishments*, Parts I to IV.
4. Id., Part I, Para. 3.
5. Convention 90/436/EEC of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises.

The preparation of standard form protocols, however, is not an ideal solution. These protocols would require a degree of separate negotiation: for example, the two countries would need to ensure that the protocols reflected their particular treaty practice and would need to identify the treaty article being amended and the effective date of the amendment. In countries having a parliamentary procedure for the approval of such protocols, each one would need to go through this procedure. Presumably, in some way, the CFA would have to indicate that the standard protocols could only be adopted in exactly the form approved by the CFA. If pairs of states altered the wording of the protocol or began to enter into wider negotiations around the protocol, much of the purpose will have been defeated.

As an alternative to standard form protocols, a more efficient solution advocated here is the adoption by the OECD of multilateral framework agreements for amending existing DTCs.

Under this approach, when the OECD decided that it is necessary to amend the wording of the OECD Model which is found in a large number of existing bilateral DTCs, the OECD would prepare a multilateral agreement, which would be concluded between all the OECD Member countries (and be open to non-OECD countries), to provide a framework for the amendment. The agreement itself would not make any amendments. Instead, it would provide a framework within which individual pairs of states could agree that the amendment in the framework agreement would apply to their existing bilateral DTC. The simplest method for doing so would be for the framework agreement to provide a declaration, signed by the representatives of the two states, to be deposited with the Secretary General of the OECD. The framework agreement would then set out the consequences of the declaration. In particular, the agreement would provide for the amendment to be made to the wording of the existing DTC. No further changes would be permitted or necessary: the procedure would be as simple as possible.

As a matter of public international law, there is no reason why a bilateral convention cannot be amended by a multilateral convention.[6] The attraction of a multilateral framework agreement, however, is that it preserves the essentially bilateral nature of DTCs by providing for the amendment to be made through a bilateral declaration.

The declaration signed by each pair of states would need to contain certain essential information. It would identify: (a) the DTC to be amended, (b) the particular article and paragraph of the DTC to be amended, (c) the effective date or dates of the amendment in each contracting state, and (d) the language or languages in which the amendment was adopted.[7] The multilateral framework agreement would contain the amended wording in the OECD's working languages of English and French plus, in all probability, two or three other languages commonly used – for example, Spanish and German. Where one or both of the pair of states concluding a declaration used another language, that other language version would be appended to the declaration. This would mean that the amended wording appeared in the same language versions as the original DTC.

Proceeding by way of a framework agreement that facilitates the amendment of existing DTCs has many advantages. First, because the amended wording fits into an existing DTC, there is no need to repeat all the definitions and other contextual material that appear in the existing DTC.

Second, the process of making a declaration within the framework of a multilateral agreement should simplify the process of making multiple amendments. Where, for example, the members of the CFA agree on an amendment to the OECD Model, each state effectively signals its willingness to conclude a series of declarations with its existing treaty partners to make the agreed amendment.

The process is not, of course, in any way restricted to the OECD Member countries. The framework agreement could provide that any state could become a party to the multilateral framework agreement and then conclude declarations with the other states with which it has a DTC.

This approach should also simplify the parliamentary procedures in countries where they are necessary. If, for example, a country became a party to the multilateral framework agreement and then concluded declarations with a significant number of its treaty partners, the multilateral agreement (with the relevant declarations appended) could go through the parliamentary procedure as a single item, at a single sitting. For example, if the United Kingdom concluded declarations with e.g. 40 of its treaty partners, a single Order in Council could bring into force the multilateral framework agreement together with the 40 declarations appended to it, and this would operate as an amendment to each of the 40 existing DTCs.[8]

A draft of a possible multilateral framework agreement is attached as an appendix to this article.

5. CONCLUDING REMARKS

Something needs to be done about the runaway success of the OECD Model. So much of the existing system of international tax law relies on a network of bilateral DTCs. This network, however, needs to be capable of flexibility and of development so that existing DTCs can be amended to take account of new circumstances and new thinking. The existing methods of amending the network – by individual protocols or by the unsatisfactory compromise of amendments to the OECD Commentaries – are inadequate to the task. A new process is needed. Hopefully, this article goes some way to suggest a possible solution to the problem.

(See the Appendix on the next page.)

6. See Aust, A., *Modern Treaty Law and Practice* (Cambridge University Press, 2000), Chap. 12.

7. The assumption here is that the language version(s) adopted would be the same as the language(s) in which the original DTC was concluded. On that basis, the declaration would simply replace the wording in the various language versions, and any rules in the original DTC dealing with priority between language versions would then apply.

8. Sec. 788 of the Taxes Act refers to arrangements specified in an Order in Council made "in relation to any territory"; assuming that the singular includes the plural, the arrangement could be made in relation to multiple territories.

APPENDIX: DRAFT MULTILATERAL FRAMEWORK AGREEMENT

The States Parties to this Agreement

Desiring to provide a framework for the expeditious amendment of provisions contained in existing conventions for the avoidance of double taxation

Have agreed as follows:

Article 1

States Parties to this Agreement may, after the date of entry into force of this Agreement, conclude a Declaration in the form set out in Schedule 1 to this Agreement, and either State may then deposit the Declaration with the Secretary General of the Organisation for Economic Co-operation and Development. The conclusion of such Declaration shall have the consequences set out in Article 2 below.

Article 2

With respect to those States whose names appear in Parts 1 and 2 of the Declaration, the convention (by whatever name known), brief details of which are set out in Part 3 of the Declaration, shall have effect from the date or dates specified in Parts 4 and 5 of the Declaration as if the provisions contained in Schedule 2 to this Agreement were inserted in place of the provisions identified in Part 6 of the Declaration (and any renumbering of the provisions of the convention shall follow accordingly). The language version or versions of the provisions inserted shall be that or those specified in Part 7 of the Declaration together with any other language versions which the States Parties to the Declaration may append to it.

Article 3

Any State, whether a member country of the Organisation for Economic Co-operation or not, may become a party to this Agreement by depositing the instruments of accession with the Secretary General of the Organisation.

Article 4

This Agreement shall enter into force on the _____ day of _____ in the year _____.

In witness whereof the undersigned Plenipotentiaries have signed this Agreement.

Done at Paris on the _____ day of _____ in the year _____.

Schedule 1: Form of Declaration

Declaration in accordance with the Multilateral Framework Agreement dated the ____ day of _____ in the year _____.

Part 1: (name of State A)
Part 2: (name of State B)
Part 3: (date and title of the existing double taxation convention to be amended)
Part 4: (date from which the amendment takes effect in State A)
Part 5: (date from which the amendment takes effect in State B)
Part 6: (article [and paragraph] number in the existing convention which is to be amended)
Part 7: (language version(s) of the amending wording)

Signed on behalf of State A:

Signed on behalf of State B:

Schedule 2: Amended text for insertion

(1) ....