EDITORIAL

The Twilight of Bilateralism

1 A word on Vogel's farewell to treaty override

Almost twenty years ago, Klaus Vogel wrote an influential article on the growing problem of treaty override.[1] On the one hand, despite acknowledging the prevalence of the opposite opinion among German scholarship, he expressed 'no doubt' that he would receive general support for his position 'in favour of giving precedence to international treaties under German constitutional law'. He also hoped that this conviction would be shared in other continental European countries.[2] On the other hand, he did not expect that the same outcome would be achieved in the United States or in 'countries which follow the United Kingdom's system'.[3] Even in such cases, however, he considered that those countries would become 'more reluctant to override treaties' if they realized the extent to which this would be 'disapproved by constitutional law in other parts of the world'.[4]

These statements may be viewed as a mere forecast and, with the benefit of hindsight, it can be claimed that his prognostics were overly optimistic. After all, Europe has never bidden farewell to treaty override, and his conviction has not become generally accepted. In the German system, the Constitutional Court has repeatedly stated that tax treaty overrides are lawful and constitutional.[5] Globally, while some jurisdictions firmly observe the *pact sunt servanda* principle, other states have systematically enacted legislation in breach of their obligations under international law.[6]

Nonetheless, the piece is far from a futurology exercise and is better interpreted as a doctrinal reaction to developments that were in course. Now, it is clear that the relationship between double tax conventions (DTCs) and domestic legislations had reached a decisive moment when the article came out. At that point, however, the trend towards the declining importance of DTCs had only begun to take shape. Vogel's contribution presents a powerful constitutional tool based on the rule of law and the Vienna Convention on the Law of Treaties (VCLT) that could be easily reproduced under the constitutional systems of most jurisdictions. Despite its optimistic tone, the fear of the declining respect for DTCs is the background of the contribution.

2 A word on the OECD's welcome to a 'new purpose' for tax treaties

In fact, the most serious problem was that treaty overrides stopped being called by their correct names. In 2003, the Organization for Economic Co-operation and Development (OECD) Commentaries abruptly extended the purpose of tax treaties, and the OECD's initial opposition to treaty overrides transformed into acceptance of the measure in situations of tax avoidance and improper use of tax treaties. The Commentaries to the 1963 OECD Model Tax Convention (OECD MC) do not mention *tax avoidance* but only affirm that 'the Fiscal Committee wishes to see how far it would be necessary to provide bilateral or multilateral solutions' to the 'improper use' of tax treaties.[7] The 1977 OECD MC was the first to include paragraphs dealing with tax avoidance in its Commentaries.[8] When addressing the purpose of tax

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1 *See* Klaus Vogel, *New Europe Bids Farewell to Treaty Override*, 58(1) Bull. Int'l Tax'n 8 (2004).

2 *See ibid.*, at 8.

3 On treaty overrides in the United States, *see* H. David Rosenbloom & Fadi Shaheen, *Treaty Override: The False Conflict Between Whitney and Cook*, 24(2) Fla. Tax Rev. 375–423 (2021). *See also* Luís Eduardo Schoueri, *Validade de Normas Internas Contrárias a Dispositivos de Acordos de Bitributação no Direito e na Prática Norte-Americana*, 13 Revista Direito Tributário Atual 119 (1994).

4 *See* Vogel, *supra* n. 1, at 8.

5 *See* on this development, Kevin Joder, *Die Hinzurechnungsbesteuerung als Treaty Override*, vol. 176, 103–105 (Duncker und Humblot 2022).

6 For a recent account on the status quo of treaty overrides worldwide, *see* Craig Elliffe, *Preventing Unacceptable Tax Treaty Overrides*, (1) Brit. Tax Rev. 38–63 (2022).

7 *See* OECD, *Draft Double Taxation Convention on Income and Capital* 27 (OECD Publishing 1963), para. 54.

8 *See* OECD, *Model Double Taxation Convention on Income and Capital*, Report of the OECD Committee on Fiscal Affairs 15 (OECD Publishing 1977) (para. 31 of the Introduction), and paras 7–10 on Art. 1.

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treaties, the Commentaries to the 1977 OECD MC assert that tax treaties should not 'help tax avoidance'.[9] This wording was maintained until 2003[10] when preventing tax avoidance became one of the purposes of tax treaties according to the 2003 Commentaries.[11] To address the new purpose of tax treaties, the OECD became more lenient with tax treaty overrides in situations when tax avoidance schemes were detected.

What changed in the OECD approach was not the concern with the *ends* but the leniency with the *means.* The apprehension with tax avoidance was not new since treaty shopping, for instance, had long been considered as a 'serious problem' that could not 'plausibly be denied by anyone'.[12] The 1986 OECD reports entitled 'Double Taxation Conventions and the Use of Base Companies'[13] and 'Double Taxation Conventions and the Use of Conduit Companies'[14] had already presented tax avoidance as a problem to be addressed. Nevertheless, according to these reports, countermeasures should be designed in accordance with the principles of international taxation and the 'spirit' of tax treaties.[15] Additionally, they should consider the 'undesirable consequences that such measures might have for other countries' since their application should be consistent with their obligations arising from tax treaties.[16] Likewise, the 1989 OECD report on 'Tax Treaty Override'[17] called for action in order to 'avoid enacting legislation which is intended to have effects in clear contradiction to international treaty obligations'.[18] Despite acknowledging the arguments to support a tax treaty override in cases of tax treaty abuse, the OECD Committee on Fiscal Affairs remained 'strongly opposed to overriding legislation' in the 1989 report.[19]

Stated differently, until the 2003 Commentaries, the OECD discussed and supported the inclusion of specific clauses in DTCs in order to account for the problems of tax avoidance and improper use of tax treaties. This approach was consistent with a liberal tradition towards treaty interpretation, privileging the wording of the provisions and the context in which they were negotiated (*pacta sunt servanda*). The reference to the purpose of preventing tax avoidance afforded opportunities for an elusive 'purposive' interpretation of DTCs, allowing treaty provisions to be tweaked in light of their new objective. This apparently slight change had many consequences that affected, for instance, the OECD's position on the compatibility of tax treaties with general anti-avoidance rules (GAARs) and with controlled foreign company (CFC) rules. As a consequence of the purposive approach, the OECD argued in both cases for the compatibility of the domestic anti-avoidance rules without acknowledging the existence of a treaty override.

In relation to the compatibility between tax treaties and domestic GAARs, the transition between the approaches is very clear. Under the 1977 OECD Commentaries, the importance of negotiating anti-avoidance provisions is stressed. Additionally, it is suggested that contracting states 'agree that the application of the provisions of domestic laws against tax avoidance should not be affected by the Convention' if this is their intention.[20] In 1992, the OECD Commentaries also inserted many alternative provisions to be adopted by states that wished to address different strategies of tax planning.[21]

According to the 2003 OECD Commentaries, the application of domestic anti-abuse provisions would not be in conflict with DTC provisions as the former would only determine 'which facts give rise to a tax liability'.[22,23] Since these rules would only provide a recharacterization

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[9] *See ibid.*, para. 7 on Art. 1.

[10] *See* OECD, *Model Double Taxation Convention on Income and Capital (September 1992, Condensed Version)*, OECD Committee on Fiscal Affairs (OECD Publishing 1993), para. 7 on Art. 1; OECD, *Model Double Taxation Convention on Income and Capital (June 1998, Condensed Version)*, OECD Committee on Fiscal Affairs (OECD Publishing 1998), para. 7 on Art. 1.

[11] OECD, *Model Tax Convention on Income and on Capital (Condensed Version)* (OECD Publishing 2003), para. 7 on Art. 1.

[12] David Rosenbloom, *OECD Report 'Double Taxation Conventions and the Use of Conduit Companies'*, (6–7) Intertax 179–182 (1988).

[13] OECD, *Double Taxation Conventions and the Use of Base Companies (Adopted by the OECD Council on 27 November 1986)*, in *Model Tax Convention on Income and on Capital 2010 (Full Version)* (OECD Publishing 2012), at R(5).

[14] OECD, *Double Taxation Conventions and the Use of Conduit Companies (Adopted by the OECD Council on 27 November 1986)*, in *Model Tax Convention on Income and on Capital 2010 (Full Version)* (OECD Publishing 2012), at R(6).

[15] OECD, *supra* n. 13, at R(5)-32, para. 93, *a).* In a similar context, *see* OECD, *supra* n. 14, at R(6)-18 and R(6)-19, para. 44, *a).*

[16] OECD, *supra* n. 13, at R(5)-32, para. 93, *b).*

[17] *See* OECD, *Tax Treaty Override (Adopted by the OECD Council on 2 October 1989)*, in *Model Tax Convention on Income and on Capital 2010 (Full Version)* (OECD Publishing 2012), at R(8). On tax treaty override, *see* Luís Eduardo Schoueri, *Tax Treaty Override: A Jurisdictional Approach*, 42(11) Intertax 682 (2014).

[18] OECD, *Recommendation of the Council Concerning Tax Treaty Override*, C(89)146/Final (2 Oct. 1989).

[19] OECD, *supra* n. 17, at R(8)-10, para. 34.

[20] *See* OECD, *supra* n. 8, para. 7 on Art. 1.

[21] *See* OECD (1993), *supra* n. 10, paras 12–21 on Art. 1. In the same sense, *see* OECD (1998), *supra* n. 10, paras 12–21 on Art. 1.

[22] OECD, *supra* n. 11, paras 9.2. and 22.1 on Art. 1. The wording was maintained until the 2017 OECD Commentaries – OECD, *Model Tax Convention on Income and on Capital 2017 (Full Version)* (OECD Publishing 2019), paras 58, 61 and 77 on Art. 1.

[23] On the debates regarding the 2003 Revisions to the OECD Commentaries, *see* Juan José Zornoza Pérez & Andrés Báez, *The 2003 Revisions to the Commentary to the OECD Model on Tax Treaties and GAARs: A Mistaken Starting Point*, in *Tax Treaties: Building Bridges Between Law and Economics* (Michael Lang et al. eds, Amsterdam, IBFD 2010);

of the income or a requalification of the taxpayer that receives the income, the provisions of the tax treaty would be applied following these modifications.[24] With this approach, the OECD managed to abruptly change its position with regard to the relationship between domestic GAARs and DTCs without having to acknowledge the existence of an override in such an interaction. The dogmatic problems of this approach have already been previously presented at length in legal scholarship.[25]

A similar pattern is observed in relation to CFC rules. Under the 1977 OECD Commentaries, the general paragraph suggesting the inclusion of a specific provision addressing the application of domestic anti-avoidance legislation should apply also to CFC rules.[26] Contracting states were expected to specifically agree on a provision addressing the possibility of the application if it was their intention to allow it. In fact, this was the approach of some of the first adopters of CFC rules. The US Subpart F provisions were covered by the saving clause,[27] and Canada insisted on the inclusion of a specific provision in all of its tax treaties after enacting CFC rules in 1972.[28] In 1986, the OECD report on base companies presented the arguments in favour and against the compatibility between CFC rules and tax treaties, also reporting the position of the OECD countries.[29] The 1992 OECD Commentaries transcribed the report without providing guidance or stating a clear position on the issue. The 1998 Harmful Tax Competition Report recommended that the OECD Commentaries take a position on the matter to clarify whether domestic anti-avoidance rules would contradict or be compatible with tax treaties adhering to the OECD Model.[30]

In 2003, the OECD Commentaries were amended in favour of the application CFCs rules even if no specific clause is included in the relevant DTC. Accordingly, CFC rules would only attribute income to the respective resident of the country imposing such rules which would not violate Article 7 or 10 of the OECD MC.[31] Like in the case of GAARs, the dogmatic problems of this approach have already been discussed at length.[32] Among other problems, this approach sets aside that profits of controlled companies are treated separately under Article 5 (7). Despite not generally dealing with income attribution, tax treaties follow the separate entity approach. The domestic choice on this matter is irrelevant since allocative rules shall be interpreted and applied independently as they are formulated 'separately from domestic tax law' with an 'independent origin and legal foundation'.[33]

The new version of the Commentaries has influenced courts around the world. One may quote, for instance, the *A Oyj Abp* case[34] and the *Gyo-Hi* case.[35] In the former, the Finnish *Korkein Hallinto-Oikeus* considered the need to address tax avoidance under the Finland-Belgium tax treaty even though no provision was included therein by the parties to support this interpretation in light of Article 7. In the latter case, the Japanese *Saikō-Saibansho* adopted the reasoning that Article 7 would not be able to preclude the application of CFC rules based on what is known as 'transparency' or 'look through approach' disregarding the legal personality of the company abroad and thus attributing the foreign profits to the parent itself.[36]

3 THE NEW PATCHWORK OF LEGAL NARRATIVES

The 2003 Commentaries were only a prologue to what would later come. The abandonment of the liberal approach inaugurated a trend towards the progressive relativization of the actual wording of DTCs and the context in which they were signed, correspondingly enthroning multiple indistinct versions of 'purposes' behind them. The use of DTCs as an instrument of investment attraction that guided the DTC policy of

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Adolfo Martín Jiménez, *The 2003 Revision of the OECD Commentaries on the Improper Use of Tax Treaties: A Case for the Declining Effect of the OECD Commentaries?*, 58 Bull. Int'l Tax'n 17 (2004); and Brian J. Arnold, *Tax Treaties and Tax Avoidance: The 2003 Revisions to the Commentary to the OECD Model*, 58 Bull. Int'l Tax'n 6 (2004).

[24] OECD, *supra* n. 11, para. 22.1 on Art. 1; OECD (2019), *supra* n. 22, paras 58, 61 and 77 on Art. 1.

[25] Instead of many, *see* Zornoza Pérez & Báez, *supra* n. 23, s. 2.3.

[26] OECD, *supra* n. 11, para. 10 on Art. 1.

[27] For the inclusion of the *saving clause* and its impact on CFC rules, *see* Georg Kofler, *Some Reflections on the 'Saving Clause'*, 44(8&9) Intertax 582–584 (2016).

[28] Brian J. Arnold, *The Evolution of Controlled Foreign Corporation Rules and Beyond*, 73(12) Bull. Int'l Tax'n 640 (2019).

[29] *See* OECD, *supra* n. 13, at R(5)-15–R(5)-17.

[30] *See* OECD, *Harmful Tax Competition: An Emerging Global Issue*, OECD Committee on Fiscal Affairs 48–49 (OECD Publishing 1998).

[31] *See* OECD, *supra* n. 11, para. 23 on Art. 1, para. 10.1 on Art. 7 and para. 37 on Art. 10. This wording has been kept in the current version of the Commentaries. *See* OECD (2019), *supra* n. 22, para. 81 on Art. 1, para. 14 on Art. 7 and para. 37 on Art. 10.

[32] *See* Luís Eduardo Schoueri, *The Objective Scope of Article 7 and the Treaty Protection to Deemed Distributed Dividends*, Kluwer International Tax Blog (27 Apr. 2015). *See also* Michael Lang, *CFC Regulations and Double Taxation Treaties*, 57(2) Bull. Int'l Tax'n 53 ff (IBFD Journal Articles & Papers 2003).

[33] Klaus Vogel, *Double Tax Treaties and Their Interpretation*, 4(1) Berkeley J. Int'l L. 14 (1986).

[34] *See* Finnish Supreme Administrative Court, Case No. KHO:2002:26, dated 20 Mar. 2002.

[35] *See* Japanese Supreme Court, Case No. 2008 (Gyo-Hi) 91, dated 29 Oct. 2009.

[36] On case law that privileges the wording and content of Art. 7, *see* Luís Eduardo Schoueri & Mateus Calicchio Barbosa, *Brazil: CFC Rules and Tax Treaties in Brazil: A Case for Article 7*, in *Tax Treaty Case Law Around the Globe 2015* (Michael Lang et al. eds, IBFD Online Books 2016).

many jurisdictions[37] became less important as it was often disregarded as a relevant purpose for legal interpretation.[38] In the following years, many general clauses were developed,[39] and the semantic limits of long-standing DTC model provisions were further tested.[40] The practical impact of such developments was to increase the power of tax administrations by either allowing them to apply domestic provisions that override DTC provisions or providing them with very broad and ambiguous powers under DTC provisions for which the content is very difficult to comprehend. In some cases, this new trend can even mean that double taxation is not avoided at all[41] thereby diminishing the effectiveness of DTCs.

The Base Erosion and Profit Shifting (BEPS) Project has demonstrated that this approach had its limitations, and international tax law is currently at a crossroads. On the one hand, the patchwork of bilateral tax treaties is deemed as insufficient. The gaps left open by them were being exploited by Multinational Enterprises (MNEs) that would not be paying their 'fair share' as a consequence of the international mobility of their assets and activities. On the other hand, considering the bilateral nature of DTCs, purposive interpretation is also of little help in this context. After all, the patchwork of DTCs also translates into a patchwork of purposes that is of no use for constructing a globally consistent system. Only the reference to a common set of rules, objectives, and goals would be able to fulfil such gaps. However, this solution raises a fundamental theoretical question. If not the bilateral DTCs, what is the source of this underlying purpose that would assist in filling the gaps being exploited by taxpayers? What is the system that will protect against the 'abuse' by MNEs?

In attempting to resolve this problem, international tax scholarship and international organizations began to increasingly engage in the development of discourses on the existence of a global approach to international taxation. Expressions such as 'international tax regime', 'single tax principle', and 'value creation' began to emerge as tentative theoretical foundations of a consistent system.[42]

The problems of these systematic aspirations are manifold. There is no international consensus with regard to the content of such an international tax regime, and the need to revisit the allocation of taxing rights is prominent. The consensus from the 1920s is largely deemed as outdated as it is unable to offer fair treatment for the current and future dynamics of economic relationships and also as a consequence of the digitalization of the economy. At the same time, there are no institutions with the legal authority to enact and enforce the rules of this system. There is no global parliament with the authority to enact rules on the 'international tax regime' and no global court with the authority to interpret them. As a consequence, the promotion of this system can only be achieved through diplomacy and the amendment of domestic regimes. As a diplomatic effort, building international consistency is a game of winners and losers, and the narratives often take the shape of the projection of domestic policies and goals onto the global scenario. The international regime is not the most fair or the most efficient but rather the system that promotes the welfare and the agenda of one dominant nation or group of nations. It is not a surprise that the legitimacy of such efforts are being questioned.[43]

The idiosyncrasies of the attempt to develop a consistent international tax regime becomes very clear when the works performed under BEPS 2.0 are considered. With regard to Pillar Two for which the interests of developed countries are stronger, no efforts are spared in the construction of extremely complex mechanisms to ensure a minimum base to tax competition. Rules that allow one state to tax income derived by residents in another contracting state were developed and, surprisingly, no conflict with the existing DTC framework is foreseen.[44] With regard to Pillar One that could be expected to benefit developing countries, the developments are slow and subject to intense opposition and controversies. The new rules are expected to demand major amendments to provisions of the DTCs currently in

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[37] *See* e.g., on the Brazilian treaty policy, Luís Eduardo Schoueri & Natalie Matos Silva, *Brazil*, in *The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties* 171–202 (Michael Lang et. al. (org.) eds, Cambridge: Cambridge University Press 2012).

[38] On the OECD's crusade against tax sparing provisions, Luís Eduardo Schoueri, *Tax Sparing: A Reconsideration of the Reconsideration*, in *Tax, Law and Development* 25–56 (Yariv Brauner & Miranda Stewart eds, Massachusetts: Edward Elgar Publishing 2013).

[39] *See* e.g., on the controversies surrounding the principal purpose test, Andrés Báez Moreno, *How Do 'The Old' and 'The New' Live Together? The Principal Purpose Test and Other Anti-avoidance Instruments in Tax Treaties*, 49(10) Intertax 771–785 (2021).

[40] On the expansion of the concept of 'beneficial ownership', *see* Jeroen J. M. Janssen & Mónica Sada Garibay, *What Should Be the Scope of the Beneficial Owner Concept?*, 48(12) Intertax 1087–1104 (2020). *See also Beneficial Ownership: Recent Trends* (Michael Lang et. al. ed., IBFD: Amsterdam 2013).

[41] For instance, the admission of double taxation in the absence of a determination to solve residence-residence taxation for non-individuals by the competent authorities; *see* OECD (2019), *supra* n. 22, para. 24.4 on Art. 4. On this matter, *see* Guilherme Galdino, *A Residência das Pessoas Jurídicas nos Acordos para Evitar a Dupla Tributação*, Doutrina Tributária Series, vol. XLVIII 307–310, 338–342 (São Paulo, IBDT 2022).

[42] Critically, *see* Elizabeth Gil García, *The Single Tax Principle: Fiction or Reality in a Non-Comprehensive International Tax Regime?*, 11(3) World Tax J. 305–346 (2019); Luís Eduardo Schoueri & Guilherme Galdino, *Single Taxation as a Policy Goal: Controversial Meaning, Lack of Justification and Unfeasibility*, in *Single Taxation?* 83–103 (Joanna Wheeler ed., Amsterdam: IBFD 2018); Luís Eduardo Schoueri & Ricardo André Galendi Jr., *Justification and Implementation of the International Allocation of Taxing Rights: Can We Take One Thing at a Time?*, in *Tax Sovereignty in the BEPS Era* 47–72 (Sergio André Rocha & Allison Christians eds, Alphen aan den Rijn: Kluwer Law International 2017); David Rosenbloom, *International Tax Arbitrage and the 'International Tax System'*, 53(2) Tax L. Rev. 137–166 (2000).

[43] *See* Yariv Brauner, *Serenity Now!: The (Not So) Inclusive Framework and the Multilateral Instrument*, 25(2) Fla. Tax Rev. (2022).

[44] Critically, *see* Luís Eduardo Schoueri, *Some Considerations on the Limitation of Substance-Based Carve-Out in the Income Inclusion Rule of Pillar Two*, 75(11/12) Bull. Int'l Tax'n 543–548 (2021); Vikram Chand, Alessandro Turina & Kinga Romanovska, *Tax Treaty Obstacles in Implementing the Pillar Two Global Minimum Tax Rules and a Possible Solution for Eliminating the Various Challenges*, 14(1) World Tax J. 3–50 (2021).

force in order to be effective – if the project ever proceeds forward. One thing they have in common is that they hardly resemble the mantra of 'value creation' that is so often repeated in the context of BEPS 1.0.

While there is no crystallization of anything similar to an international system, legal interpretation is influenced by considerations that are merely political at their core. The patchwork of bilateral DTCs now overlaps with that of legal narratives on the nature and content of the envisioned international tax regime. While it previously accepted that the chain of bilateral DTCs would be exploited by taxpayers,[45] such a framework does not seem to suffice in some environments. At the same time, we are very far from anything similar to a consistent international tax regime. At best, the regime is now at 'an intermediate stage'[46] of development in which the actors are in constant change, and a stable outcome to the allocation rules has not been reached as there are no solid principles guiding the current design of rules. In any case, this is an environment of extreme uncertainty.

The prospective candidates for a dominating legal narrative are not promising. BEPS 2.0 shows that value creation is already being abandoned less than a decade after debuting in international tax debates with the aspirations of a legal principle. The single tax principle is completely unable to offer the basis of a consistent international regime – and each and every author seems to have a different meaning in mind when enunciating it.[47] In this context, it is still too early to dismiss bilateralism. Despite the setbacks from the last decades, these conventions are still the primary source of international tax law and will remain as such in the foreseeable future. For this reason, jurisdictions should cherish their DTC networks, and bidding farewell to treaty overrides is as important today as it was twenty years ago.[48]

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[45] *See* e.g., Klaus Vogel, *Steuerumgehung nach innerstaatlichen Recht und nach Abkommensrecht*, (4) Steuer und Wirtschaft 369–381 (1985).

[46] Wolfgang Schön, *Is There Finally an International Tax System?*, 13(3) World Tax J. 384 (2021).

[47] *See* Schoueri & Galdino, *supra* n. 47, at 83–103.

[48] *See* for this author's approach on the topic, Schoueri, *supra* n. 17, at 692.