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A Systems-Based Approach to Tax Treaties

Henri Torrione[1]

1. Introduction

The purpose of this contribution is to draw the attention of tax lawyers to a central feature of tax treaties: a tax treaty is a system, or at least it establishes a system or a mechanism. This central feature (which is here termed the "systemic" character of tax treaties) has not yet received adequate attention among tax lawyers. This is regrettable for the following reason: if one is not aware that this is a central feature of tax treaties, it is not possible to understand the grounds on which the OECD Committee on Fiscal Affairs (CAF) has implicitly based its recommendations in the 1999 Report on the Application of the OECD Model Tax Convention to Partnerships (the Partnership Report).

With a systems-based approach, these grounds can be easily understood and formulated: because of this central feature, in tax treaties the whole is more than just the addition of the parts (this is true for any system, not just for tax treaties), and the treaty obligations of the contracting states are not constituted just by the addition of the obligations resulting from specific articles of the treaty (from the parts). The treaty obligations of the contracting states also include obligations deriving from the whole (the overall structure of the treaty). The recommendations of the Partnership Report are mainly based on the overall structure of the OECD Model Tax Convention on Income and Capital (the Model).

Every tax lawyer dealing with tax treaties is aware of the importance of these recommendations for the interpretation of tax treaties; most of these recommendations have in fact been incorporated into the Commentary to the Model (the Commentary). At the same time, the controversial characters of these recommendations are also well known; some states have expressed reservations to the relevant paragraphs of the Commentary, and various authors have written opposing the CAF approach.[2]

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1. Professor at the University of Fribourg (Switzerland).
2. See for instance Lang, Michael, *The application of the OECD Model Tax Convention to Partnerships – A critical analysis of the Report prepared by the OECD Committee on Fiscal Affairs*, (London/Boston: La, 2000).

In order to explain the controversial character of these recommendations, it is necessary to refer to the opposing views among tax lawyers on the true nature of treaty rules: there are those who see treaty rules as primarily rules establishing (between two contracting states) a mechanism (a system and a set of processes resulting from the operation of such a system), and those who see tax treaties primarily as a set of substantial rules which should be taken into consideration one after the other, as if the overall structure of the treaty, the mechanism put into place by the treaty and the operations determined by such a mechanism could not generate independent obligations for the contracting states.

It is likely that the conclusions of the Partnership Report will appear readily acceptable to those who expressly or implicitly view tax treaties as mainly a set of mechanisms and processes. On the contrary, those who view tax treaties as mainly an addition of substantive rules and principles, are likely to reject the conclusions of the Partnership Report.

The present contribution will argue that a tax treaty is mainly a question of structures, mechanisms and processes, a question of *system* and of *system operations*. According to the present contribution, this feature is a central feature, even *the* central feature of tax treaties: the object and purpose of tax treaties is to establish structures, mechanisms and processes. For this reason, treaty obligations derive not only from specific articles of the treaty but also from the overall structure of the treaty. This paper can therefore be viewed as a defence of the position taken by CAF in the Partnership Report. It is a defence based on an argument not expressly made in the Partnership Report, but to which the Partnership Report is referring indirectly through the use of expressions such as "the basic purposes of the Convention",[3] the "structure of the Convention", the "implicit principle" contained in the Convention and the "factual context in which the Convention is to be applied".[4]

2. Systems theory and tax treaties

The "general system theory"[5] describes what is "systemic" not only in machines, organisms and psychic systems, but also in social systems such as economics, technology (see the various studies on "the systemic character

3. Partnership Report, Para. 52.
4. Partnership Report, Para. 53.
5. Luhmann, Niklas, *Social Systems*, translated by Bednarz, John, with Baecker, D. (Stanford: Stanford University Press, 2003).

of modern technology"), politics and law (see the analysis of Luhmann on law as a social system[6]). By observing various types of systems and studying their behaviour, it then identifies and describes characteristics that are common to all systems.

If systems theory is applied to bilateral tax treaties, a tax treaty could be viewed as establishing a sub-system operating in the environment constituted by the different (possibly conflicting) legal systems of the two contracting states.

What precisely are the "systemic" elements in a tax treaty? In my opinion, it is first of all the *mechanism* that the treaty establishes between the two contracting states in order to avoid double taxation. It is also the operations of this mechanism, which could be described as a process, or as a set of processes. It is also the fact that the relevant processes (as we will see, there are two different processes) are determined mainly by the structure of the Model. It is finally the fact that the two different processes each have a specific way to organize the respective interventions of the domestic laws of the contracting states in the operation of the convention (a specific way of coding their environment, according to the expression used by the system theory).

The view that tax treaties have these "systemic" elements could be supported by the way tax lawyers usually analyse tax treaties. We shall show that this is the case for each of the four "systemic" elements just listed.

(1) Treaty rules establish an independent mechanism. According to Vogel, tax treaty norms are neither conflict rules (conflict rules can be found in international private law, but the problem in international taxation is not choosing between the application of domestic or of foreign legislation), nor rules which allocate the jurisdiction to tax (the right to tax) to one of the two contracting states (the states have original jurisdiction to tax and do not rely on tax treaties for this). Again according to Vogel, tax conventions "establish an independent mechanism to avoid double taxation through restriction of tax claims in areas where overlapping tax claims are expected or at least theoretically possible".[7]

6. Luhmann, Niklas, *Law as a Social System*, translated by Ziegert, Klaus A., (Oxford: OUP, 2004) and *Legitimation durch Verfahren* (Berlin: Suhrkamp Verlag, 1983).
7. *Klaus Vogel On Double Taxation Conventions*, 3rd edn, (Dordrecht : Kluwer Law International, , 1997), p. 26, Para. 45a and 45c.

On the basis of Vogel's view, the present contribution supports the view that a tax treaty is not primarily a set of substantive rules or principles. A tax treaty does not really contain substantive law, contrary to a codification treaty or to domestic legislation. It rather contains a set of rules and principles that establishes a mechanism. And the term "mechanism" does not designate a mechanism of adjudication, with the creation of an independent tribunal and the possibility of legal proceedings to enforce substantive law, as in the case of the European Convention on Human Rights for instance. In the case of tax treaties, the term "mechanism" designates something else, very different. This paper tries to describe it in an abstract way, with the help of systems theory: the mechanism established by a tax treaty is a *system*, i.e. "a configuration of parts connected and joined together by a web of relationships".[8]

(2) The operations of this mechanism (or according to the terminology used by tax lawyers: "the application of the tax treaty") can be described as processes. According to systems theory, the operation of a system is a process, or a set of processes. A process "is a sequence of interdependent and linked procedures which, at every stage, consume one or more resources (employee time, …) to convert inputs (data, …) into outputs. These outputs then serve as inputs for the next stage …".[9]The application of a tax treaty can be described as a process, or as a set of processes, specified and articulated together by the system (by the independent mechanism established by the tax treaty).

(3) The two specific processes involved in the application of the treaty are determined by the structure of the system put into place by the treaty. It is possible to show that the application of a tax convention includes two individual processes that can be precisely identified, and that these two processes are specified by the structure of the treaty. This structure results from the division of the treaty into chapters, and from the relationships between the different chapters.

In order to underline the connection between these processes and the structure of the convention, the first process is called "Chapters 1/3" process, and the second process "Chapters 3/5" process (Chapter 2 of the Convention is only a list of definitions, and Chapter 4 is the same

8. See for this definition and for other definitions Bela Banathy, *A Taste of Systemics*, p. 5, 27.03.2010, www.isss.org/taste.html.
9. See www.BusinessDictionary.com

as Chapter 3 in the web of relationships between the chapters, and substitutes Chapter 3 when the issue is net wealth).

In the case of a partnership the first process (Chapters 1/3 process) is (1) about access to treaty benefits and (2) the processing of the conflict of attribution for partnership income (whether attribution of the income described in the distributive rules is to the partners or to the partnership under the treaty when the domestic laws of the two contracting states takes conflicting positions in this respect).

In the case of a partnership the second process (Chapters 3/5 process) is about (1) the taxation (or limited taxation) of the partnership income in the source state under Chapter 3 of the treaty, (2) the corresponding credit or exemption in the residence state under Chapter 5 of the treaty, and (3) the processing of the conflict of qualifications for partnership income when the domestic laws of the source state are conflicting with the domestic laws of the residence state with respect to the qualification of the partnership income.

(4) Each of these processes has a specific way to organize the interaction between the conflicting domestic laws of the contracting states and the treaty. The processing of the conflicting claims of the contracting states may be viewed as one of the central function of these two processes. This is in conformity with systems theory. According to this theory, a system (a machine, an organism, etc.) is characterized by the specific way it is processing data extracted from its environment (a specific way of "coding their environment", according to the expression generally used by systems theory). As a tax treaty is operating in the environment constituted by the laws of the two contracting states (it is a sub-system operating in the environment constituted by the different domestic laws of the two contracting states, as indicated above), it is characterized by the way it is processing the conflicting claims made by the domestic laws of the contracting states. The application of the treaty is "coding the environment" (the legal systems of the two contracting states) by giving priority either to the laws of the residence state, or to the laws of the source state.

Such an interaction is precisely the central issue in the Partnership Report, in which the CAF discusses how the Model should apply to partnerships when the domestic laws of the two contracting states differ in the treatment of partnerships. The Partnership Report shows that conflicting claims processed by a treaty (a choice must

necessarily be made by the treaty between the two conflicting claims of the contracting states) are not only straightforward claims about the right to tax an item of income, but may also include claims that are legally more complex: either claims relating to the attribution of the partnership income (is it attributable to the partners or to the partnership?), or claims relating to the qualification of the partnership income (is this item of income an interest paid to the partner who is lending money to the partnership, or is this a business profit of this partner?).

One process (the Chapter 1/3 process) gives priority to the residence state, and the other (the Chapter 3/5 process) to the source state. Priority is determined by the specific structure of each process, and the structure of the processes is the result of the structure of the convention (not the result of the wording used in Art. 3(2)!)

3. The Partnership Report and the systems-based approach

The Partnership Report focuses primarily on factual examples. On the basis of the analysis of these examples, the CAF concludes that the difficulties created by partnerships in the application of tax treaties may be solved through "a better co-ordination in the application and interpretation of some of the provisions of tax conventions".[10] The Partnership Report contains several recommendations for a better co-ordination. Most of them have been introduced in the OECD Commentary in 2000. A short description of these recommendations may be useful.

The Partnership Report has two parts. The first part discusses access to treaty benefits for partnerships and partners and attribution rules for partnership income (attribution to the partners or to the partnership) when the domestic laws of the two contracting states differ in the treatment of partnerships. In order to avoid the mismatch described in the following section (The Chapters 1/3 interaction, below at 3(2)(A)), the Partnership Report addresses the following recommendation to the source state: "The source State, in applying the Convention where partnerships are involved, should take into account, as part of the factual context in which the Convention is to be applied, the way in which an item of income arising in its jurisdiction

10. Partnership Report, Para. 26.

is treated in the jurisdiction of the taxpayer claiming the benefits of the treaty as a resident".[11]

The second part of the Partnership Report discusses conflict of qualifications. In order to avoid the other type of mismatch described in the following section (The Chapters 3/5 interaction, at 3(2)(B) below), the Partnership Report makes the following recommendation to the state of residence of the partnership (or of the partners): "Where, due to differences in the domestic law between the State of source and the State of residence, the former applies, with respect to a particular item of income, provisions of the Convention that are different from those that the State of residence would have applied to the same item of income, the income is still being taxed in accordance with the provisions of the Convention, in this case as interpreted by the State of source".[12]

The author agrees with these recommendations, and also with the corresponding amendments introduced in the OECD Commentary. A more radical approach in the same direction is desirable. Whereas the OECD approach focuses on factual examples and is inductive and pragmatic, this paper tries to develop a theoretical approach, which focuses on the "systemic" character of tax treaties and which uses the system theory developed by the German philosopher Niklas Luhmann. Such a theoretical approach does not replace the inductive approach of the Partnership Report, and its discussion of factual examples, but is a theoretical extension of inductive approach.

As a result of our systems-based approach, three modifications to the presentation of the OECD position in the Partnership Report are recommended.

(1) The "co-ordination in the application of tax conventions" recommended by the Partnership Report should be viewed as more than just a recommendation. Co-ordination in the application of tax conventions is required by what the OECD calls the "structure of the Convention".[13] Each of the two individual processes involved in the application of the Model organizes this co-ordination in a very precise way. Because of these two processes (because of the structure of

11. Partnership Report, Para. 53.
12. Partnership Report, Para. 105.
13. See in particular Partnership Report, Para. 53 and for an analogous approach, see Para. 103.

the convention which specifies and organizes these processes), co-ordination is a treaty obligation for the two contracting states, and not just a recommendation.

(2) The second modification to the OECD approach is maybe not substantial but more a question of presentation. In the author's opinion, the co-ordination organized by the two processes put into place by the Convention is more than just "a better co-ordination in the application and interpretation of some of the provisions of tax conventions".[14] It is deeper than that. What is co-ordinated by the mechanism established by the treaty, when the domestic laws of the two contrating states differ in the treatment of partnerships, is the way such conflicting domestic laws interact with the treaty. The treaty itself, through the mechanism it establishes between the contracting states, organizes this interaction in an orderly and structured way. Interaction is not organized by Art. 3(2), which only provides that an interaction may take place, but is the result of the structure of the Convention (a structure with an articulation of Chapter 3 with Chapter 1, and with an articulation of Chapter 5 with Chapter 3). In this paper these processes are called the Chapters 1/3 process, and the Chapters 3/5 process, and the two ways in which conflicting domestic laws interact with the Convention, as the Chapters 1/3 interaction, and the Chapters 3/5 interaction.

(A) The Chapters 1/3 interaction. This is discussed in Part 1 of the Partnership Report. When the difficulty caused by the use of a partnership in a tax treaty context is whether the partnership income should be attributed to the partners or to the partnership, the domestic law which interacts with the treaty is the domestic law of the state of residence of the partnership (or of the partners), not the domestic law of the state of source of the income. The source state has to follow the approach taken by the domestic laws of the residence state in that respect. If the domestic laws of the residence state treat the partnership as a taxable entity (for instance Spain), the source state (for instance Switzerland or Germany) will have to accept that the domestic laws of the residence state interact[15] with the provisions of the Convention in this respect, and affect in this respect its position

14. Partnership Report, Para. 26.
15. See the Commentary on Arts. 23A and 23B, Para. 56.3.

when it is applying the distributive rules of the Model. This coordination would eliminate the following mismatch: the person who is resident of one contracting state and has access to the benefits of the treaty is not the person to which the source state would attribute the partnership income when applying the relevant distributive rule, because the person who has access to the treaty benefits is for instance the partnership, and the persons to whom the source state attributes the income when applying the distributive rules are for instance the partners. There would be a fundamental mismatch between Chapter 1 and Chapter 3 of the Model. According to a "non-systemic" view of tax treaties, such a mismatch may well exist in a tax treaty that follows the Model, and can be avoided only by the addition of specific provisions to the Model. According to the opposite view (the view presented in this paper, which is proposing a certain way of looking at tax treaties, a systems view or a "systemic" view), such a mismatch cannot exist under the Model, because the articulation of Chapter 3 with Chapter 1 is part of the very object and purpose of the treaty. Such a mismatch is not in accordance with the unity and coherence of the individual process, Chapter 1/3 process (the unity and coherence of such a process are the result of the structure of the convention).

(B) The Chapters 3/5 interaction. This is discussed in Part 2 of the Partnership Report under the heading "Conflicts of qualification". When the difficulty caused by the use of a partnership in a tax treaty context is related to income characterization, when given the same facts the two states would apply different distributive rules on the basis of differences in their domestic laws with respect to the treatment of partnerships, the relevant domestic law is the law of the state of source of the income, not the law of the state of residence of the partnership (nor of the partners). The residence state has to accept the characterization of the income under the laws of the source state for the identification of the relevant distributive rule. This would avoid another type of mismatch, a mismatch that may result in double taxation or in double non-taxation. This type of mismatch might happen even between countries which both treat partnerships as transparent. For instance in case of a loan made by a partner to his partnership, one country may have to recognize this loan under its domestic law in spite of the transparency of the partnership (for instance Switzerland has

to recognize such a loan under Swiss domestic laws), and will therefore apply Art. 11 to the interest paid to the partner, while the other contracting state may have to refuse to recognize the loan (for instance Germany under German domestic law), and will therefore treat the interest paid to the partner as business income of the partnership under Art. 7. Therefore when the issue under Art. 23 is whether the source state taxation is in accordance with the distributive rules of Art. 6 to 22, the laws of the source state should prevail. The residence state has to accept that the domestic laws of the source state interact with the provisions of the convention, and affect indirectly its position. Otherwise, there would be a mismatch between Chapter 3 and Chapter 5 of the Model. Such a mismatch is not in accordance with the unity and coherence of the individual process I have designated as the Chapter 3/5 Process.

(3) As a result of the present systems-based approach to tax treaties, new insight may be gained, not only into how tax treaties work, but also into the recommendations of the Partnership Report. A certain unification of the OECD bifurcated approach in Part 1 and Part 2 of its Report is possible. The present systems-based approach unifies these two parts of the Partnership Report because it shows that in the two parts of the Partnership Report the same issue is discussed: the interaction between the domestic law treatment of partnerships and the tax treaty. It unifies these two parts also because it explains the different way in which this interaction works in Part 1 and in Part 2 of the Report, by making reference to one central feature of all tax treaties following the basic structure of the Model (their "systemic" character).

4. The two processes

A tax treaty establishes a mechanism (a system), and the operations of such a system are constituted by two individual processes.

4.1. The Chapters 1/3 process

This is a process by which Arts. 6 to 22 are connected to Arts. 1 and 4. The process can be described as follows: access to treaty benefits (Arts. 1, 3 and 4), with the resulting determination of the entity entitled to treaty benefits,

and the resulting identification of the state which has the role of state of source, and will be subject to the limitations contained in Arts. 6 to 22 (most of these limitations affect the source state).

The rules governing the first process are formulated mainly in Arts. 1 and 4. The treaty rules are not substantive rules, but rather "rules of the game" which organize the co-ordination between the two contracting states. This process is dominated by an extensive use of the domestic law of the state of residence (see in Art. 4(1) the expression "under the laws of that State").

As the process ends up with the identification of the state to which most of the limitations contained in Arts. 6 to 22 are addressed (the source state), application of Arts. 6 to 22 is to be co-ordinated with the rules applicable to the identification of the entity which is entitled to treaty benefits for the partnership income. If source state is aware that only a systems-based approach is in accordance with the "systemic" character of the Model, if it recognizes that the Model has a clear structure, with an articulation of Chapter 3 with Chapter 1, it is obvious that the distributive rules contained in Arts. 6 to 22, including their attribution element, can only be applied by the source state within "the factual context"[16] constituted by the application of Arts. 1 and 4 by the residence state (interaction between the domestic laws of the state of residence and the treaty rules). This means that, if the source State recognizes that the income is partnership income, it will have to attribute that income to the partnership if the partnership has access to treaty benefits, or to the partners if the partners have access to treaty benefits (or to the partners with respect to one treaty and to the partnership with respect to another treaty, if several treaties apply). The opposite position would be based on the assumption that a tax treaty is only an addition of isolated provisions, with no structure under which Chapter 1 and Chapter 3 are articulated together, with no obligation deriving from such an articulation.

4.2. The Chapters 3/5 process

Application of the distributive rules of Arts. 6 to 22, and then, if necessary, application of Art. 23, is a distinct process. The output of this second individual process is the prohibition on the source state to tax the income under the relevant distributive rule, or the obligation for the residence state to give credit or exemption for source state taxation in accordance with the treaty.

16. Partnership Report, Para. 53.

Application of the distributive rules of Arts. 6 to 22 is the starting stage of the second individual process organized by the Model. This is a process under which Art. 23 is connected to Arts. 6 to 22, and the process can be described as follows: application by the state of source of the relevant limitations addressed to it in Art. 6 to 22, and then, if necessary, elimination of the remaining double taxation by the state of residence, through credit or exemption (Art. 23). The rules of Art. 23, far from being substantive rules which codify the law applicable to the contracting states, are different for State A and State B. As said above, tax treaties contain rules which establish a mechanism, not substantive rules.

For the state of residence, the situation is the following (leaving aside the four articles that attribute an exclusive taxation right to the source state for income arising from a transport enterprise and government service): as most of the distributive rules provide for the unlimited taxing right of the state of residence, in parallel with the right of the source state (limited or unlimited, depending on the circumstances), the conventions mandate that the state of residence eliminates the "residual"[17] double taxation, provided that the taxation by the source state is "in accordance with the provisions of this Convention" (Art. 23A and 23B of the Model).

If the state of residence is aware that only a systems-based approach is in accordance with the "systemic" character of the Model, if it recognizes that a central element of the structure of the Model is the connection of Chapter 5 with the rules of Arts. 6 to 22 (Chapter 3), it will be clear for the residence state that "the way [it] eliminates double taxation [the way it applies Art. 23] will depend, to some extent, on how the Convention has been applied" by the source state,[18] as a result of its domestic laws (interaction between the domestic laws of the source state and the treaty rules). The opposite position would be based on the assumption that the only way for the residence state to have the obligation to accept the way how the convention has been applied by the source state, is the existence of a specific provision formulating such an obligation. According to such a view, the way the treaty works (taxation by the source state under its limited or unlimited taxing rights under the treaty, and then application of a credit or exemption by the state of residence), even if this clearly is part of "the basic purposes of the Convention",[19] may be disregarded in the absence of a specific provision added to the Model.

17. Commentary on Art. 23A and 23B, Para. 7.
18. Partnership Report, Para. 103.
19. Partnership Report, Para. 52.

5. Processes with reflexive relationships

The two individual processes organized by tax treaties are sophisticated processes dealing with complex data. These processes are capable of reflexive relationships.[20] They have in particular the following complex "systemic" characteristics:

– Role-taking.[21] If one is aware of the "systemic" character of tax treaties, one understands that the attribution of the role of the residence state to one of the two contracting states, and of the role of the source state to the other state, is an output at one stage of the first process organized by the Model (the "Chapter 1/3" process).
– Perspective. Role-taking generates the possibility of perspective. The processes use not only non-reflexive data, but also the specific viewpoint (perspective) of one of the contracting states (a view point depending from its role) on non-reflexive data.

5.1. Role-taking

The role taken by each contracting state, as the state of source respectively as the state of residence, combined with the interaction of their domestic laws with the convention as a consequence of their respective role, is central in the mechanism established by the Model.

It was clear before the publication of the Partnership Report in 1999 that the distribution of the roles between the two contracting states could result from the domestic law of one state only, where only one state claimed the right to subject a person to tax on his worldwide income or capital (Art. 4(2) and (3) only applies when the two contracting states claim that right, i.e. in case of concurrent full tax liability to tax).

With the Partnership Report in 1999, one discovers that the effect of role-taking is broader than that. It can also affect the treatment of a partnership for tax treaty purposes, when the laws of the two contracting states differ in the treatment of partnerships. The role determines which domestic law interacts with the convention in this respect, with differences according

20. According to Luhmann, see note 5, social systems such as law or economics are a self referential system, with self-description, self-elaboration, i.e. with reflexive relationships.
21. Role-taking refers to social interaction in which people adopt and act out a particular social role (see Blackwell Encyclopedia of Sociology).

to two individual processes. The interaction is not the same when the difficulty caused by the use of a partnership in a treaty context is whether the partnership income should be attributed to the partnership or to the partners (the Chapters 1/3 process), and when it is a difficulty related to income characterization in connection with a partnership (the Chapters 3/5 process).

Using a metaphor, one can say that for certain types of issues, each state has to follow to the letter the score that the other state plays in one circumstance or the other. The state of source has to follow the score that the other state plays in some circumstances (this score for the state of source is the "factual context in which the Convention is to be applied"[22]). The state of residence has to follow the score played by the state of source in other circumstances (this score is for the state of residence "how the Convention has been applied" by the source state[23]).

5.2. Perspective

One will pay attention to the intensive use by the Partnership Report of an approach that one could call a "perspective approach" or an "aspectual approach".[24] The CAF always limits its statements to the specific viewpoint of either the state of source or the state of residence of the partnership, respectively the state of residence of the partners. This perspective is central in the application of the Model.

This perspective approach – one could even use the terms instrument or tool, or perspective method, since this is a technique that can be applied for its instrumental value – consists in applying the provisions of a treaty by taking into account the specific viewpoint that each state takes. For example, when discussing the meaning of a provision of a treaty, one has to be aware of the fact that one may take the viewpoint of the state of source, respectively the viewpoint of the state of residence. As another example, one has to be aware of the fact that when, according to the tax treaty entered into between Switzerland and the UK, one comes to the conclusion that company A is a resident of the United Kingdom and not of

22. Commentary on Art.1, Para. 6.3; Partnership Report, Para. 53.
23. Partnership Report, Para. 103.
24. See Papaux, Alain, *Essai philosophique sur la qualification juridique: de la subsomption à l'abduction – L'exemple du droit international privé*, (Zurich/Basel/Geneva: L.G.D.J./Schulthess/Bruylant, 2003), p. 523.

Switzerland, this conclusion is valid from the perspective of this tax treaty. A different conclusion could be reached if the case were examined from the perspective of the tax treaty entered into by Switzerland and France, or from the perspective of the tax treaty entered into by France and the United Kingdom.[25]

The perspective approach can be illustrated by the example of the conflict between two residences. When two contracting states claim that the same person has unlimited tax liability according to their respective domestic laws, there is a conflict which is solved by the treaty. This conflict is, however, solved by a provision having a procedural character. As stated by the the Commentary to the Model, where a person is a resident of State A according to Art. 4(2) and (3), one may not conclude that this provision lays down a special rule on residence and that one shall disregard State B's domestic law because its rules are incompatible with the provisions of the treaty. In actual fact, "in the case of such a conflict a choice must necessarily be made between the two claims, and it is on this point that the Article proposes special rules".[26] That is the reason why, where the Commentary refers to the term "residence", it always specifies that this is "for the purposes of the Convention". The Commentary hence stresses the procedural character of this approach. It is related to the two contracting states and to this specific treaty, and not necessarily relevant to the domestic law.[27]

The perspective resulting from role-taking (the role of source state and the role of residence state) plays a technical function in the application of tax treaties to partnerships. The Partnership Report is replete with expressions such as "for the application of the Convention by the State of source".[28] It is perspective that allows these two different interactions between the domestic laws of the two contracting states and the treaty. The interaction is

25. See the Parent Subsidiary Directive for the shift from a relativist view to a view taking into consideration all the convention in force for a given State: "For the purposes of this Directive 'company of a Member State' shall mean any company which: […] according to the tax laws of a Member State is considered to be resident in that State for tax purposes and, under the terms of a double taxation agreement concluded with a third State, is not considered to be resident for tax purposes outside the Community" (Art. 2(b) of the Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, Official Journal L 225, 20/08/1990 pp. 6 et seq.).
26. Commentary on Art. 4, Para 7.
27. Other position: Peter Locher, *Einführung in das Internationale Steuerrecht des Schweiz*, 2nd edn.n, (Bern 2000), p. 89.
28. See for instance Partnership Report, Para. 25.

in fact a coordination of the perspectives of the two contracting states, with an order according to which the perspective of a given state (for example, the perspective of the source state, as regards the allocation of an item of income to a given resident person) should "take into account […] the way in which an item of income arising in its jurisdiction is treated" in the other contracting state.[29]

This perspective approach is not to be understood subjectively. On the contrary, it refers to an objective dimension, in the sense that the point of view on a landscape or a city objectively depends on the point where the observer is standing in this landscape or in this city. This position is an objective element that contributes to the formation of the perspective of the observer. Einstein's Theory of Relativity has helped us to understand that the observer cannot be separated from what is observed, and that it is necessary to take into account the position of the observer in relation to the position of the object of its observation. This is obvious in physics and much more in social science. The central merit of the Partnership Report: understanding that relativity (but not subjectivity) is central to the application of tax treaties. Relativity and perspective are part of the two processes (the Chapter 1/3 process and the Chapter 3/5 process), which have therefore a reflexive element (as do the operations of other systems, even natural (i.e. not man-made) systems according to systems theory).

6. Conclusion: Interpretation of the tax treaties under Art. 31 of the Vienna Convention and systems-based approach

This paper does not examine whether the systems-based approach presented above can be defended as a correct interpretation of the Model under the Vienna Convention on the Law of Treaties (pursuant to Art. 31(1) of the Vienna Convention, "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 issue is not discussed here, apart from the following three observations.

The Vienna Convention does not contain any element that can be understood as opposed to a systems-based approach. Because of the place given to the context in Art. 31 (1) (the […] meaning to be given to the terms of the treaty *in their context*), the Vienna Convention can even be read as an

29. Partnership Report, Para. 53.

active promoter of a systems-based approach. The reference to the context in Art. 31 (1) could be understood as follows if a "systemic" perspective is adopted: each part of a treaty (each term of the treaty, each article of the treaty) gets its meaning from the whole and by its interaction with all the other parts of the treaty.

This way of looking at the context cannot be adopted generally, for any kind of treaty. It can, however, be adopted when this way of looking at the context is clearly in line with the object and purpose of the treaty. We argue that this is the case for tax treaties. When the treaty is a tax treaty following the basic structure of the Model, the "structure" of the treaty[30] is not only an element of the "context" of the treaty, but is also narrowly connected with "the object and purpose" of the treaty. How the structure of a treaty can be considered as narrowly connected with the object and purpose of the treaty? Is the structure of a treaty not just a presentation issue, a drafting issue? Not for tax treaties. As indicated above, one of the basic purposes of a tax treaty is to "establish an independent mechanism to avoid double taxation through restriction of tax claims in areas where overlapping tax claims are expected or at least theoretically possible".[31] The mechanism and its operations are however *determined mainly by the structure of the treaty*. Therefore, for tax treaties, the structure of the treaty is not only a question of "context"; it is also a question of object and purpose of the treaty. For this reason, as we would argue that a systems-based approach can probably not be avoided for tax treaties. This position may find an additional support in an analysis of the historical and official documents drafted in the preparation of the OECD Model Convention of 1963, between 1956 and 1963, and also in the older convention drafted under the League of Nations. As in 1956–1963 several sub-committes were working separately at the same time on separate parts of the draft, the overall structure of the draft was an issue when the separate pieces were put together and connected among themselves. Further research needs to be done in this respect.

The structure of the treaty is not only the result of the division of the treaty into chapters (with a specific order among the chapters, and titles to the chapters). Specific articles, in particular Art. 4 and Art. 23, are also dealing with issues relating to the structure of the Model. We have already given some indications with respect to Art. 4 (see 5.2). Art. 23 obliges the state of residence to eliminate double taxation with respect to the "income

30. Partnership Report, Para. 53.
31. See note 7.

[…] which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State". According to the Partnership Report,[32] "the wording of Art. 23 is crucial in that respect". It is crucial in evidencing the articulation of Chapter 5 and Chapter 3 of the Model (what has been designated in this paper as the "Chapter 3/5" interaction). This central articulation has been precisely analysed by John Avery Jones and his co-authors in an article published in 1996[33] (Credit and Exemption under Tax Treaties in Cases of Differing Income Characterization), 3 years before the publication of the Partnership Report. This was done on the basis of the precise wording of Art. 23. According to John Avery Jones, "there can be only one correct interpretation of what is in accordance with the provisions of the Convention [under Art. 23 of the Model] and this does not vary according to whether it is looked at from the point of view of the source state or residence state. This is necessarily determined by the characterization of the income by the source State".[34] If this interpretation is correct, as we think it is, the systems-based approach presented in this paper is also required, up to a certain extent, by the very wording used in Art. 23 of the Model.

32. Partnership Report, Para. 104.
33. 36 *European Taxation* 118; [1996] BTR 212.
34. Id. at 119.