The European Court of Justice and Interpretation of Tax Treaties

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The decision of the CJEU in *Republic of Austria v Federal Republic of Germany* (Case C-648/15) on 12 September 2017 is a landmark decision in tax treaty dispute resolution. Han Verhagen raised important questions about the Court as an arbitrator for tax treaty disputed in his blog-post on 13 September 2017. One obvious benefit in appointing the CJEU is that its decisions are public with the result that they inform on the meaning of the treaty they are called upon to interpret. Whatever the benefits to the competent authority and the taxpayer in question of confidentiality in MAP arbitration, publicity serve the wider public interest in the contribution the decisions may make to the subject. The emphasis on confidentiality in the BEPS MLI, in contrast, means that the benefit of the insights of the arbitrators will be for the parties to the dispute only.

In this piece I consider the approach of the court to tax treaty interpretation. In choosing an arbitrator, one of the key questions is whether the arbitrator has the knowledge and experience of the area of law to resolve the issues satisfactorily. The CJEU is a court of general jurisdiction. In the course of its heavy workload, it considers issues in almost every aspect of human interaction and across all areas of law impacted by EU jurisdiction. The benefit of such a court is that no area of law becomes isolated from legal thinking and law generally by only being discussed among those who specialise in that area. Unlike other areas of law, many of those engaged in taxation are not lawyers and do not have exposure to law in a more general way. A non-specialist tribunal can therefor maintain the essential link with other areas of law.

International tax specialisation

On the other hand, technical issues that are particular to an area of law are often best solved by specialist tribunals who have the deep knowledge of the area and of the issues. The complexity of modern law means that it has become impossible for lawyers (or judges) to have detailed expertise outside a specific area of practice. Any tax practitioner or administrator knows that even within taxation there are so many sub-specialisations that it is impossible to know about all. A private client expert may find resolving a complex VAT question as difficult as it might be for a non-tax practitioner for example. A specialist tribunal may therefore dispense a more accurate decision and dispense a better form of justice, more quickly in such cases.

What are Genusscheine?

The question facing the CJEU in this case was one that called for a specialist tribunal. The issue was the classification for treaty purposes of "genusscheine". This instrument may be issued by companies established under the corporate law of a number of civil law jurisdictions including both Austria and Germany. They are unknown in common law countries. I have much interest in this topic having spent time considering how genusscheine are to be classified for UK tax purposes. The difficulty in classification arrived because the terms under which the instrument may be issued can have debt or equity characteristics, or a combination of both.

The case concerned genusscheine issued by a German bank and held by an Austrian bank. The issue was whether payments made pursuant to the genusscheine should be treated as dividends or interest under the Austria-Germany double tax treaty of 24 August 2000. Article 11(2), in common with OECD Model treaties contains a definition of interest which excluded payments under instruments with "participation in profits" (Forderungen mit Gewinnbeteiligung) from the definition. The Austrian bank requested MAP under article 25(1) of the treaty. The competent authorities were unable to resolve the issue and so the Bank invoked binding mandatory arbitration under article 25(5) with the CJEU as the arbitrator.

The Court's approach to interpretation

The Court's initial approach was impeccable, referring to the general principle of interpretation in article 31(1) of the Vienna Convention on the Law of Treaties. That

principle requires treaties to be interpreted in good faith in accordance with the ordinary meaning of terms, in context, and in the light of the treaty's object and purpose. This was followed by a reference to article 3(2) of the Austria-Germany treaty which requires a term not defined in the treaty to have the meaning that it has under the tax law of the contracting state applying the treaty, unless the context requires otherwise. Article 3(2) is unique to tax treaties, not being found in other forms of treaty.

Germany argued for the meaning of the term "participation in profits" (Forderungen mit Gewinnbeteiligung) to be determined by reference to its domestic law, and in particular, on a decision of the Bundesfinanzhof (Federal Finance Court, Germany) that payments under such instruments are to be regarded as participation in profits.

The German interpretation was summarily rejected by the Court for two connected reasons. Firstly, it said that such a rule of interpretation by a single state is not a rule intended to arbitrate between divergences of interpretation between the two states. Secondly, it would deprive the arbitration provisions of Article 25(5) of "all practical effect". The brevity of the reasoning makes it difficult to follow. In principle the conclusion seems to be flawed. Since the issue was whether the German law meaning was to be given, the interpretation and application of article 3(2) should have formed a central part of the analysis. The fact that the dispute was to be resolved by arbitration does not mean that article 3(2) itself, is incapable of being addressed. The dispute is not just about the meaning of the term in article 11(2) but whether article 3(2) is the appropriate route to determine the meaning in 11(2). Categorising the German argument as a single state interpretation is a misconception about how article 3(2) works.

Advocate General's approach to article 3(2)

Advocate General Mengozzi provided a somewhat more robust analysis of article 3(2). In his opinion, the context required otherwise and the autonomous meaning in in article 11(2) was to be decided under the principles in article 31(1) of the Vienna Convention on the law of treaties. He relied exclusively on the OECD Model Convention and the Commentaries to provide this context.

In my view this is a case where strong arguments can be made for the application of domestic law by operation of article 3(2). An important consequence of article

3(2) is that terms in a tax treaty can have different meanings in different circumstances. That outcome may be confusing to lawyers who are used to interpreting other treaties, where in principle, there is only one meaning to be given to any term in a treaty where the Vienna Convention principles are properly applied. This is the classic situation that makes a compelling case for a specialist international tax tribunal to resolve such disputes.