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Tax treaties in time of conflict

Jonathan Schwarz (Temple Tax Chambers; King's College London) · Tuesday, August 29th, 2023

It has been 60 years since publication of the OECD 1963 Draft Double Taxation Convention on Income and Capital. That model has provided the core and structure of all subsequent model double tax treaties published by the OECD, the UN and some states. During this period the number of bilateral tax treaties has grown exponentially. The OECD estimated that there were more than 3,000 bilateral tax treaties at the time of the BEPS project: OECD Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15.

Encouragement of international trade and investment

The underlying reason for tax treaties is the encouragement of international trade and investment by providing an agreed allocation of taxing rights and the elimination of double taxation as a factor in trade and investment decisions. The use of treaties governed by international law, rather than domestic mechanisms, offers a higher degree of stability as a part of the rules-based international order. They form a firm and reliable basis for tax relations between States.
While the content of tax treaties changes, the idea that overlapping taxing rights be addressed by agreement remains constant, with few dissenters. This consensus is in line with modern views that the relations between states are best served by an international legal framework backed by effective international institutions.

Invasion of Ukraine

The invasion of Ukraine in February 2022 by Russia, a permanent member of the UN Security Council, sent shock waves through this international order which have also manifested themselves in cracks appearing in the tax treaty network. Unsurprisingly Ukraine terminated its tax treaty with Russia by notice on 20 June 2022.
The UK was quick off the mark in suspending exchange and sharing of tax information with Russia and Belarus on 17 March 2022. The stated reasons were to "inflict economic pain on Putin's regime" and to "help starve Putin of the resources he needs to carry out his barbaric campaign of violence."
Latvia unilaterally suspended its treaty with Russia indefinitely from 16 May 2022. On 2 June 2023 Denmark terminated its treaty with Russia, having determined that it is not in Denmark's interest to continue having a tax treaty with Russia.
By way of retaliation, on 8 August 2023, a Russian decree temporarily suspending specific provisions of tax treaties with 38 "unfriendly" states. These states are European countries plus Australia, Korea, Japan and the United States. These effectively eliminate the provisions allocating

taxing rights and the mutual agreement procedure. Generally, relief from double taxation for individuals is retained.

Legal basis

These actions are designed to inflict economic damage and disruption to trade and investment. Is there a legal basis for them?
Termination of treaties is perhaps the most straightforward in international law. Article 54 of the Vienna Convention on the Law of Treaties specifies that a treaty may be terminated in conformity with the terms of the treaty. Article 31 of the Model treaties makes provision for such termination.

Unilateral measures to deny rights granted by treaty are commonly in the nature of treaty overrides. The OECD Report of the Committee on Fiscal Affairs of 9 June 1989 on Tax Treaty Override observed that a treaty override is a breach of the treaty.
When the UK received notice of suspension of its treaty with Russia, it issued a statement on 18 August 2023 pointing out that the treaty does not permit this unilateral action and asking Russia to reverse the suspension. On 19 August 2023, The Russian Ministry of Finance issued a press release in response, noting non-compliance with its treaties including the suspension of the exchange of tax information with Russia. The Russian press release cites the Vienna Convention on the Law of Treaties as the legal basis for the suspension of the selected treaty provisions.
Article 60 of the Vienna Convention allows suspension of a treaty in whole or part in the case of a material breach by one of the parties. A material breach consists of either a repudiation of the treaty (Article 60(3)(a)) or the violation of a provision essential to the accomplishment of the object or purpose of the treaty (Article 60(3)(b)).
The title and preamble to the UK-Russia treaty include "the prevention of fiscal evasion with respect to taxes on income and capital gains" in the stated purpose of the treaty. Article 26 (exchange of information is the only provision that deals with prevention of fiscal evasion in the treaty.

Exchange of information

Is the refusal to exchange information a material breach of that treaty?
Article 26(1) requires the competent authorities of the two states to exchange "such information as is necessary for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes covered by this Convention insofar as the taxation thereunder is not contrary to this Convention". However, any information may only be disclosed to persons or involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the covered taxes and may only be used for those purposes.
Any disclosure to persons other than the tax authorities, or use for unauthorised purposes would be in contravention of the treaty and grounds for refusing to supply information.
More importantly, Article 26(2)(c) removes the obligation to supply information the disclosure of which would be contrary to public policy (ordre public). Vogel suggests that compatibility with fundamental values such as the rule of law, would preclude disclosure. He also considers that violation of international fundamental rights such as under the European Convention on Human Rights would justify a refusal to exchange information. This compatibility is determined by reference to the public policy of the requested state.

The spread of treaty termination

It is not only tax treaty relations with Russia that are coming under pressure in the context of current conflict. Ukraine also terminated its tax treaty with Iran over weapons supply to Russia on 4 August 2023. On 7 August 2023 Burkina Faso gave notice of termination of its tax treaty with France. The reason given here was France’s refusal to renegotiate the treaty despite requests to do so in 2020 and 2021. This too is in the context of strained relations between France and some francophone African countries.
It is clear that tax treaties are not just technical instruments. They form part of the international legal infrastructure that both reflects and provides the context for wider international relations. A deterioration in the international legal order will not leave tax treaties unscathed.

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