
Chapter 2

The Structure and Workings of Art. 2 of the OECD Model Conventions

*A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used.*¹⁸⁸

Art. 2 of the OECD Model Conventions provides a system whereby the taxes covered under the treaty are determined. The framework provided in this Article is largely adhered to in treaty practice. In the application of tax treaties, the mode to ascertain whether certain payments are within treaty coverage is therefore generally analogous. However, as automated as the adoption and application of this provision seems to be, it does prompt unclear points that have resulted in differences of opinion among contracting parties.

The preliminary remarks to the OECD Model Commentaries on Art. 2¹⁸⁹ give the following broad explanation of the structure of this Article:

The Article is intended:

- to make the terminology and nomenclature relating to the taxes covered by the Convention more acceptable and precise;
- to ensure identification of the Contracting States' taxes covered by the Convention;
- to widen as much as possible the field of application of the Convention by including as far as possible, and in harmony with the domestic laws of the Contracting States, the taxes imposed by their political subdivisions or local authorities;
- to avoid the necessity of concluding a new Convention whenever the Contracting States' domestic laws are modified; and
- to provide for the periodic exchange of information about changes which have been made in their respective taxation laws.

188. Justice Oliver Wendell Holmes in *Towne v. Eisner*, 245 U.S. 418, 425 (1918).

189. OECD, Commentaries on the Articles of the Income and Capital Model Convention of 15 July 2005, Commentary on Art. 2, m.no.1; Commentary on the Estates and Inheritances and on Gifts Model Convention of 3 June 1982, Commentary on Art. 2, point I., m.no. 1.

These formulations originate from the exact same wording contained in the Commentary on a Draft Art. 2 adopted by the OECD Fiscal Committee in 1957¹⁹⁰ and have been used ever since in the official OECD Commentaries to describe the general object and purpose of Art. 2.

Until 1963, when the Draft Conventions of the OECD Fiscal Committee were turned into “full-fledged” Model Conventions, this basic outline of Art. 2 was followed by the statement: “The clauses are framed as simply and comprehensibly as possible and in a similar manner for taxes on income and capital and taxes on estates and inheritances.”¹⁹¹ This statement is still accurate with respect to the present Model versions of Art. 2.¹⁹²

In the following, closer consideration will be given to the four paragraphs of Art. 2, separately as well as with a view to their interconnectedness. Special attention will be given to the Reports of experts appointed to the Committee on Fiscal Affairs by the governments of Member countries.

At a session of the OEEC Fiscal Committee in 1956, the agenda was laid down to study, *inter alia*, “the listing and definition of taxes on income and capital.”¹⁹³ This was followed by the institution of WP No. 3, consisting of Delegates from Italy and Switzerland, who submitted, as a result of their studies of the existing tax treaties, a Report containing Draft Conventions (cf. Annex I) and Commentaries thereto.¹⁹⁴ Following this Report, a draft article was adopted by the Fiscal Committee, the formulations of

190. FC(57)1, Paris, 17 October 1957, p. 4.

191. FC(57)1, p. 4; OEEC, Report of the Fiscal Committee on its Work, FC(68)2 (1st Revision) Part II, Annex A, m.no. 2. The texts, in substance, differ only in two aspects: until 1963, Art. 2 contained a Para. 5 stating: “The competent authorities of the two States shall by mutual agreement clarify any doubts which may arise as to the taxes to which the Convention ought to apply.” This is in line with Para. 3 of Art. 25 (Mutual Agreement) and was thus deleted in the context of Art. 2. The second major difference is that gifts were not included in the Estates and Inheritances Model Convention before they were incorporated in the 1982 Model Convention.

192. These older versions of Art. 2, in substance, differ only in two aspects: until 1963, Art. 2 contained a Para. 5 stating: “The competent authorities of the two States shall by mutual agreement clarify any doubts which may arise as to the taxes to which the Convention ought to apply.” This is in line with Para. 3 of Art. 25 (Mutual Agreement) and was thus deleted in the context of Art. 2. The second major difference is that gifts were not included in the Estates and Inheritances Model Convention before they were incorporated in the 1982 Model Convention.

193. FC/M(56)1 (Prov.), p. 3.

194. OEEC, WP No. 3 of the Fiscal Committee (Italy-Switzerland) on the Listing and Definition of Taxes on Income and Capital (including Taxes on Estates and Inheritances) which should be covered by Double Taxation Agreements, Paris, 10 January 1957, FC/WP 3(57)1.

which are virtually identical to those in the 1963 OECD Model Conventions (cf. Annex I).

In 1967, the OECD Fiscal Committee established WP No. 30¹⁹⁵ and appointed the experts from Austria and Switzerland, inter alia, to analyse existing treaties and deal with difficulties encountered in the application of Art. 2. The considerations in the 1969 Report of WP No. 30¹⁹⁶ shed further light on the texts of the 1963 Model Conventions and Commentaries and served as a guideline in the drafting of the 1977 Income and Capital Model Conventions.

The considerations contained in the above-cited OECD Working Party Reports have in principle lost none of their actuality with regard to current treaty practice, as Art. 2 has seen no fundamental changes in structure and wording since its 1963 version (cf. Annex I).

2.1. The general description in Art. 2(1) and (2)

In both OECD Model Conventions, Art. 2(1) states in a general manner the scope of application of the treaty, namely “taxes on income and on capital” and “taxes on estates, inheritances, and on gifts”.¹⁹⁷ As can be deduced from the wording that the Convention “shall apply to” said taxes, the function of this statement is more than just an introductory headline; it aims to set a general boundary for the cases of double taxation it is designed to prevent. Art. 2(1) is to be read in conjunction with Art. 2(2) since it enlarges on the statement made in Para. 1.

The OECD Commentaries on Art. 2(2) in both Model Conventions state that this paragraph “gives a definition” of the taxes covered. However, the

195. OECD, Fiscal Committee, Summary record of the 27th Session held at the Château de la Muette, Paris, 2 October, 1967, FC/M(67)2, m.no. 1: “The Fiscal Committee set up Working Party No. 30 to examine Articles 2, 3, 6, 13 and 22 of the O.E.C.D. Draft Double Taxation Convention on Income and Capital 1963 in order to complement and improve these Articles and to study problems arising in connection.”

196. OECD, WP No. 30 of the Fiscal Committee (Austria-Switzerland), Paris, 27 June 1969, FC/WP 30(69)1.

197. The OECD Commentary to the Income and Capital Model Convention on Art. 2(1) states: “This paragraph defines the scope of application of the Convention: taxes on income and on capital ...” The Commentary to the Estates, Inheritances and Gifts Model provides: “This paragraph establishes the scope of the Convention as to the taxes covered, namely: taxes on estates and inheritances and taxes on gifts.”

“definition”¹⁹⁸ of the taxes covered in Para. 2 bears more resemblance to an observation than a definition: Taxes on income and on capital are described as “all taxes imposed on total income, on total capital, or on elements of income or of capital ...” Indeed, a certain tautology¹⁹⁹ can be detected, similar to the circular definition of an elephant stating, “An elephant is large and grey and lives in a herd of elephants.”²⁰⁰

The description in Art. 2(2) of the Estates, Inheritances and Gifts Model Convention is slightly more expressive: taxes on estates and inheritances are described to be “taxes imposed by reason of death in the form of taxes on the corpus of the estate, of taxes on inheritances, of transfer duties, or of taxes on *donationes mortis causa*”, whereas “[t]here shall be regarded as taxes on gifts taxes imposed on transfers *inter vivos* only because such transfers are made for no, or less than full, consideration.” Greater detail of this description in comparison to the description in the Income and Capital Model Convention can be explained by the fact that the area of *donationes mortis causa* and *donationes inter vivos* is per se a special matter as opposed to the broad field of income and capital taxation primarily relied on in most countries.²⁰¹

With respect to Art. 2(1) and (2), the Report of WP No. 30 states:

Both paragraphs together describe in a fundamental and general way, but without going into details, the taxes to which the Convention applies. These taxes are then – provided they are in force at the time of signature of the Convention – enumerated by note in the lists of paragraph 3; the special purpose of this paragraph in its present form is merely to illustrate what was said generally in paragraphs 1 and 2.²⁰²

The Report also observes that “the general descriptions given in Paras. 1 and 2 are not too precise and might probably be called to be rather vague.”²⁰³

198. The OECD Commentaries on Para. 2 state that this paragraph “gives a definition” of the taxes covered in the respective Model Convention.

199. Cf. also K. Vogel, speaking of a tautology in his Commentary on Art. 2(2), m.no. 30.

200. See Williams/Morse, *Davies: Principles of Tax Law*, 2004, p. 3; the authors employ this notion to illustrate the difficulty of defining the term “tax”.

201. The substance of the concept of “taxes on income and capital” and “taxes on estates and inheritances and on gifts” will be dealt with elaborately in Chapter 3 of this study. Further elaboration in this vein does not serve the present purpose of evaluating the functional framework provided in Art. 2.

202. FC/WP 30(69)1, p. 5, m.no. 7.

203. *Id.*, m.no. 9.

Nevertheless, the important role of Paras. 1 and 2 cannot be overestimated: the adoption of an international treaty entails that common solutions are to be found on the basis of the text that has been agreed upon. By adopting the broad terminology of Paras. 1 and 2 in their treaty text, the parties have expressed objective intent as to their being bound accordingly, in line with the declared purpose of Art. 2 to “widen as much as possible the field of application of the Convention.” This explains why states will often choose to omit Paras. 1 and 2 in the text of Art. 2 and limit their scope of agreement to such taxes as are explicitly listed.

2.2. The list of taxes in Art. 2(3)

The idea of a blank list to be filled in by the contracting states as to their respective taxes covered under the treaty has taken centre stage in Model Tax Conventions ever since the very first Drafts of the League of Nations. The regular text of the OECD Income and Capital Model Convention provides for an enumeration of taxes that is merely of illustrative character, as clearly indicated by the phrase “in particular”. The listing in the Estates, Inheritances and Gifts Model Convention, on the other hand, is exhaustive. This could be explained by the fact that the field of taxes on estates, inheritances or gifts is much more contained, whereas taxes in the area of income and capital existing in a given state will regularly be numerous; in particular, taxes on income have in many states functioned as an “engine of the revenue”²⁰⁴ and have taken numerous forms and variations.

The wording “in particular”, indicating that the list is not exhaustive, can be found in treaties in the area of income and capital as early as 1925.²⁰⁵ Looking to the roots of tax treaty practice (cf. Annex II), the inconsistency with respect to exhaustive or non-exhaustive listings becomes obvious and it is equally prevalent in the current tax treaty network. Earlier treaties sometimes coupled a general description of the taxes covered with an express provision for agreement of the contracting states as to the taxes covered. US and UK treaties have had a close connection to the League of Nations

204. Plehn, “Review of ‘The Income Tax. A Study of the History, Theory, and Practice of Income Taxation at Home and Abroad’ by Edwin R.A. Seligman”, 5 *The American Economic Review* 1 (March 1915), p. 115.

205. See, e.g., Art. 1 of the 1925 Direct Taxes Convention and Final Protocol between Italy and the German Reich (published 31 October 1925; effective 1 January 1926).

Drafts²⁰⁶ and thus regularly provide for an exhaustive listing of the taxes covered.

The Commentary on Art. 2(3) states: “The list is not exhaustive. It serves to illustrate the preceding paragraphs of the Article. In principle, however, it will be a complete list of taxes imposed in each State at the time of signature and covered by the Convention.”²⁰⁷ As Lang has pointed out,²⁰⁸ the statement seems to a certain extent contradictory: on the one hand, the list is expressly said not to be complete but, on the other hand, it should “in principle” be seen to be exhaustive.

The roots of this formulation in the Commentary can be traced back to the work of WP No. 3 of the OEEC Fiscal Committee. The Italian Delegate noted in his Commentary:

The object of the list provided for in the third paragraph of the draft is clear. Such a list gives the Contracting States and each taxpayer an accurate idea of the field of application of the Convention. The Italian Delegate considers that the list provided should not be irrevocable but should merely serve to illustrate the preceding paragraphs of the draft. However, in view of the high qualifications and experience of the persons whose duty it is to conduct the preliminary discussions for a Convention, it is safe to say that in practice the lists are complete and authoritative for the interpretation and application of the Conventions.²⁰⁹

The Swiss Delegate, with respect to the identical text in Para. 4 of his Draft (cf. Annex I), is less wordy: “Paragraph 4 lists the taxes imposed by each of the two States at the time of signature of the Convention.” The Commentary to the Draft eventually adopted by the Council (cf. Annex I) supports the explanations of the Italian Delegate in stating as follows:

Paragraph 3 lists the taxes in force at the time of signature of the Convention. The list is not exhaustive. It serves to illustrate the preceding paragraphs of this Article. In principle, however, it will be a full list of the taxes imposed in each State at the time of signature and covered by the Convention.²¹⁰

206. Flick, “Zur Auslegung von Normen des Internationalen Steuerrechts”, in Felix (ed.), *Von der Auslegung und Anwendung der Steuergesetze*, 1958, p. 160.

207. Para. 6 Income and Capital Model Convention Commentary.

208. M. Lang, “‘Taxes Covered’ – What Is a ‘Tax’ According to Art. 2 OECD Model Convention?”, *Bulletin for International Fiscal Documentation* (2005), p. 220.

209. FC/WP 3(57)1, Commentary by the Italian Delegate, under point C., at m.no. 6.

210. OEEC, Fiscal Committee, Listing and Definition of Taxes on Income and Capital, Including Taxes on Estates and Inheritances, which should be covered by Double Taxation Agreements, Paris, 17 October 1957, FC(57)1, Commentary on the Draft Article, point II., m.no. 9.

The non-exhaustive listing obviously accounts for an assumption on the part of the contracting parties that despite their respective “high qualifications and experience”, they may forget to enumerate certain taxes, due to the fact that there will regularly be a broad field of taxes in the area of income and capital in the various states. This is confirmed by WP No. 30, which sees problems in an exclusive listing in that “[a] wrong decision about the character of a tax or ‘forgetting’ a surcharge would mean that those levies were not within the scope of the Convention, even if later on both Contracting Parties admitted that the tax in question should have been enumerated in the list.”²¹¹

Lang argued that such forgetfulness can plausibly be presumed only with regard to taxes that are not major revenue-raising taxes of the respective state, because treaty negotiators can be deemed to be extremely careful to include such major taxes.²¹² Büge makes this argument with respect to taxes that have had a firm and substantially stable place in the taxation system of the state.²¹³ This assumption, although it will regularly be true in practice, is not generally supported by WP No. 30:

The list of taxes will also give in principle a *complete* picture of all taxes imposed in each State at the time of signature and covered by the Convention. However, taxes *not* enumerated in paragraph 3 but qualifying for a test under paragraphs 1 and 2 are – under the present O.E.C.D. concept – nevertheless within the scope of the Convention. (emphases in the original)

Thus, if the parties incorporate broad general descriptions in the sense of Art. 2(1) and (2), coupled with a merely illustrative list of taxes covered, the objective intent can be seen to be of the character to “broaden as much as possible the scope of the Convention.” Although it is highly unlikely in practice (“in principle ... it will be a complete list”), it is not generally ruled out that even major taxes on income and capital that are not mentioned in the non-exhaustive list may still come within the substantive scope of the treaty. In case of a dispute, unless it is established that the tax at issue was omitted purposely, the presumption should be that a tax omitted in the illustrative listing of Art. 2(3) will nevertheless be covered if it comes under the general descriptions of Art. 2(1) and (2). This approach best serves the purpose of Art. 2 to clarify the scope of the Convention: exclusions of a tax from the intended broad scope should be explicitly made cognizable by the contracting parties.

211. FC/WP 30(69)1, m.no. 11.

212. M. Lang, “Taxes Covered”, p. 220.

213. Büge in Becker/Höppner et al. (eds.), “Commentary on Art. 2(3)”, m.no. 35.

Apart from ensuring, in connection with Art. 2(1) and (2), a broad scope of the treaty, the non-exhaustive nature of Para. 3 could also be seen to serve another function: Lang²¹⁴ makes the point that treaty negotiations usually span a considerable period of time, involving several rounds of negotiations; this makes it difficult, in the event of changes in the tax law of each of the contracting states, to go back to issues that have already been discussed. Art. 2(3) could thus take account of events such as the introduction of a new tax in one or both of the states before the finalization of negotiations and signing of the treaty. There is no hint in the materials backing that this was, in fact, a consideration in the drafting of the Model text. The words “conclusion” and “signature” are used interchangeably throughout the materials, as well as in the current Commentaries. Still, whether this was intended or not, the non-exhaustive list will undeniably have this effect, which serves practicability in treaty negotiations and will generally be in the interest of the contracting parties. This is in line with the finding that the demonstrative listing was instituted to diminish cases of mutual consultation of the parties in unclear cases as to the taxes covered.

2.3. Art. 2(3) relating to Paras. 1 and 2

The general description of the taxes covered, alongside a list of taxes covered given by each of the contracting states, raises questions as to how these paragraphs are interrelated. The inclusion of a general description does not always go hand in hand with the adoption of a merely illustrative listing; for instance, the Estates, Inheritances and Gifts Model Convention includes a general description despite the fact that the list therein is of exclusive nature. Similarly, the 2006 US Model contains an exhaustive listing coupled with a general description.

Baker has stated that Paras. 1 and 2 have no stand-alone significance within the structure of Art. 2.²¹⁵ Wassermeyer has argued that the list in Para. 3 restrains the general descriptions in Paras. 1 and 2, as it will in general be a complete listing.²¹⁶

214. M. Lang, “Taxes Covered”, p. 220.

215. Baker, Commentary, 2B.04: “Of themselves, these two paragraphs are of limited practical significance, but they are relevant when determining what constitute ‘identical or substantially similar’ taxes under paragraph (4).”

216. Wassermeyer in Debatin/Wassermeyer, *Doppelbesteuerung*, 2004, Commentary on Art. 2, m.no. 11.

This, however, begs the question why the abstract definitions do feature in the current Model texts. In conformity with the customary legal principle *ut res magis valeat quam pereat*,²¹⁷ as well as with a view to the object and purpose of Art. 2 to “widen as much as possible the field of application of the Convention”, it cannot be assumed that Paras. 1 and 2 are without substance.²¹⁸

The non-exhaustive list in Art. 2(3) cannot thus restrict the scope laid out in the wording of Paras. 1 and 2. If the parties have incorporated a general description equivalent to Paras. 1 and 2, it will not suffice to look to Para. 3 to determine the taxes covered. The parties can be held to their express consent on such broad coverage as expressed in the general description. If they wish to limit their commitment, they are free to do so, as is specifically recognized in the Income and Capital Model Convention Commentary:

Some Member countries do not include paragraphs 1 and 2 in their bilateral conventions. These countries prefer simply to list exhaustively the taxes in each country to which the Convention will apply, and clarify that the Convention will also apply to subsequent taxes that are similar to those listed.

Countries that wish to follow this approach might use the following wording:

‘1. The taxes to which the Convention shall apply are:

- a) (in State A):
- b) (in State B):’²¹⁹

With respect to the importance of Paras. 1 and 2, WP No. 30 states:

The omission of paragraphs 1 and 2 would primarily affect the position of paragraph 3: under the present scheme, the ‘ultimate responsibility’ for the determination of the subject of the Convention goes with paragraphs 1 and 2; ... [L]eaving out paragraphs 1 and 2 would mean that the scope of the Convention is determined solely by the list of taxes in paragraph 3; and this would imply that the enumeration of taxes therein must be *exhaustive* ...²²⁰ (emphasis in the original)

217. This principle, also called “principle of effectiveness”, was recognized by the ICJ in the YBILC 1966, Vol. II, p. 219: “When a treaty is open to two interpretations one of which does and the other does not enable the treaty to have appropriate effects, good faith and the objects and purposes of the treaty demand that the former interpretation should be adopted.”

218. See also the argument to this effect in Sutter, “Der Sachliche Anwendungsbereich des ErbSt-MA”, in Aigner et al. (eds.), *Erbschaftssteuern und Doppelbesteuerungsabkommen*, 2002, p. 62.

219. Point 6.1. of the Income and Capital Model Convention Commentary to Art. 2(3).

220. FC/WP 30(69)1, m.nos. 7 and 9.

This supports the view that Paras. 1 and 2 play an independent role in the determination of taxes covered. It also indicates that Art. 2(4) (analysed in more detail below) plays an equally important role irrespective of whether the list in Art. 2(3) is exhaustive or merely demonstrative.

On its face, omitting Paras. 1 and 2 and adopting an exhaustive listing seems to facilitate treaty application. There are, however, serious pitfalls to this decision.

WP No. 30 elaborates:

If paragraphs 1 and 2 were omitted and the list of taxes was made exhaustive, ... the scope of the Convention – at least as far as the ‘existing taxes’ are concerned – would then be described in a most precise form. But it should be borne in mind that the importance of an exhaustive list which determines for itself the subject of the Convention goes far beyond that of a list which serves only as illustration for a general formula. The elaboration of an exhaustive list would therefore cause much more problems and difficulties than the compilation of a list of the present paragraph 3. It would not be sufficient for the Contracting Parties to agree only on the principle that all taxes on income (capital) within the meaning of the general definition of paragraphs 1 and 2 should be covered by the Convention, but each Contracting Party would be obliged to scrutinize most carefully every single tax, accessory duty, charge, contribution and any other levy of any form of both Contracting States to find out whether such tax should be mentioned in the list.²²¹

In accordance with the objective intent expressed by the incorporation of general descriptions in the sense of Paras. 1 and 2, these Paragraphs should be seen to have importance in their own right, independently of the list in Para. 3. Whether the tax at issue qualifies as a “tax on income and capital” under the treaty is to be determined also, but not exclusively, with a view to the illustrative listing the parties have provided. To prevent the broad coverage provided in Paras. 1 and 2, the parties are free to lessen the substantive scope of their treaty – either by forgoing certain elements of the broad description of Paras. 1 and 2,²²² or by restricting the substantive scope to specifically enumerated taxes. In this respect, Paras. 1 and 2 can be seen to preserve the broad scope of the Convention.

One could make the argument that Paras. 1 and 2 can also have a “restricting” function with respect to the enumerated taxes in Para. 3. With respect

221. Id., m.no. 11.

222. States frequently limit the scope of application to “taxes on income” by deleting the reference to “taxes on capital” in Paras. 1 and 2.