

Rethinking Article 15 of the OECD Model in Light of Digitalization

Kluwer International Tax Blog

June 3, 2019

Svetislav V. Kostić (University of Belgrade, Faculty of Law)

Please refer to this post as: Svetislav V. Kostić, 'Rethinking Article 15 of the OECD Model in Light of Digitalization', *Kluwer International Tax Blog*, June 3, 2019, <http://kluwertaxblog.com/2019/06/03/rethinking-article-15-of-the-oecd-model-in-light-of-digitalization/>

The quest to align the international tax order with the challenges posed by the digital economy has so far mostly focused on solving issues involving incorporated structures. What is somehow escaping the attention of the tax treaty policymakers is the fact that it is not only in the domain of companies that we have lost our ability to rely on physical presence as the principle factor determining the nexus with a particular jurisdiction for tax purposes or where we are struggling to characterize the payments being made in the context of new business models. Article 15 of the OECD/UN Models, quite similarly to Article 5 of the respective Models, resonates of the past. In reading the permanent establishment definition found in tax treaties, one cannot resist the impression that one is standing before a world of huge blast furnaces, steel mills and coal, sirens leading to thousands of workers going through huge factory courtyards. Provisions governing the taxation of employment income in tax treaties offer the same sensation. We are living in an age where labour lawyers are hotly debating the essential concepts, such as who is an employer and who is an employee. Failure to answer these questions means that we cannot conclude whether a particular remuneration represents payment in respect of employment, an exercise without which the application of the provisions governing the delineation of taxation rights over employment income becomes impossible. Furthermore, as in the case of Article 5 of the OECD/UN Models, Article 15 is fundamentally reliant on the concept of the physical presence of an individual in the respective treaty state.

From a policy perspective, one may conclude that Article 15 of the OECD/UN Models is based on an unquestionable reliance on the primacy of the residence state taxation principle or, to be more precise, on the belief that an individual's tax residence is sufficient proof of their fundamental relationship with a particular contracting state, which justifies the enjoyment of tax treaty benefits and the limitation of source state taxation rights. The source state link is established by virtue of the physical presence of an individual when performing their employment and is conditioned on additional factors that testify as to the existence of a more substantial relationship with the state in which employment is exercised.

However, citizenship as well as (tax) residence of individuals is becoming increasingly offered for sale by numerous jurisdictions in the world. From the opposite angle of view, widespread reliance on the concept of domicile, which uses archaic instincts to establish a person's link with a particular place, or legal concepts which allow us to easily disguise these instincts, may offer the protection of a country's tax residence and its network of double taxation treaties to those individuals who no longer have any strong personal links with their territory.

In relying on geographical presence of individuals for taxation purposes (determining residence or confirming source state taxation prerogatives) we still take for granted a sedentary life style, which requires some form of permanence in one particular geographical spot (our home). We assume, based on thousands of years of experience, that those of us endowed with families will not be able to travel freely, but will always be, as if by a magnet, drawn to his or hers loved ones. In other words, we still view the existence of the family (understood in its reproductive role, i.e. children and other dependents) as a given. However, population statistics from most of the world's nations suggest that while it is perhaps still too early to dismiss the family as one of the most relevant connecting factors in respect of determining residence, it does stand to reason that it is worth contemplating on the possible alternatives or at least variations. As the mean age for bearing children rises, the family connecting factor losses in relevance at least for a considerable portion of a person's productive life. Our modern world is also forcing us to re-examine the very concept of the nucleus family, as single parenting, or childbirth out of wedlock is becoming more common throughout the world.

It was not only the need to shelter our families and store food that lead us to a sedentary way of life. For most people, the tools needed to perform their everyday work required the existence of a permanent settlement as they were either too cumbersome to carry over large distances, or were owned by someone else who in their own right demanded attendance on site (e.g. feudal lords). Some of those reading this blog may still remember the days when not working during our holidays was not a subjective, but rather an objective decision. We simply were not able to bring our workstations with us on vacation. Today, we are capable, in an increasing number of professions, of exercising our employment in any place offering an Internet connection for our laptops. The days of the office are long gone.

The application of Article 15 of the OECD Model (as well as of the UN Model and thus the vast majority of double tax treaties in the world today) is fundamentally related to the interpretation of the terms "employment" and "employer", terms which are not defined in any of the models in use today.

In addition to the mundane conclusion (already made by earlier commentators) that if a common understanding of the term "employment" truly exists, an autonomous definition of the term should be provided in the OECD Model, or at least in the Commentary, a more valid one can be made with respect to the potential dangers that reliance on fluid labour law concepts, such as the employment relationship, can have for the future of tax treaties. Developments in labour law will strive to protect the rights of employees in an economic environment in which it is no longer certain who the employee is, who the employer is and what constitutes an employment relationship. (International) tax law does not have an identical purpose to labour (employment) law, and this premise should be borne in mind when introducing "foreign" concepts into the ambit of tax legislation. More importantly, labour law is clearly deviating from the age old dichotomy, on which our double taxation treaties also stand, of independent and dependent work and we are seeing before our very eyes the emergence of a third, intermediary category, a category which is mostly a result of the new digital and collaborative economy.

Bearing in mind the processes described above, three conclusions can be offered for rethinking Article 15 of the OECD Model in light of digitalization:

- Tax residence of individuals can no longer be used as an impartial criterion for the determination of nexus with a particular jurisdiction. Tax residence is not only being offered as a tradable commodity, but the criteria currently relied on for ascertaining a deep personal link with a certain country (permanent home, family) are no longer of unquestionable integrity.
- The current understanding of how employment is exercised needs revisiting, as the concept of the workplace is disappearing before our very eyes. Unlike in the domain of corporate income taxation, a satisfactory debate on the issue of business (work) presence in connection with taxing individuals has yet to even begin.
- The terms "employment" and "employer" can no longer be used with certainty of meaning, and it is not the difference in interpretation between the contracting states that is the main issue. We are facing a situation where we will not be able to say with certainty what they encompass from the perspective of each individual contracting state. Thus, the issue is not whether a particular state applied the appropriate article of a tax treaty, but which article it should apply.