

# **European and International Tax Moot Court Competition - 2015/2016**

## **Memorandum for the applicant Memorandum for the defendant**

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Il presente lavoro nasce dalla partecipazione dell'Università Luiss Guido Carli alla European and International Tax Moot Court Competition organizzata dalla European Tax College Foundation di Lovanio.

Si tratta di una competizione che riproduce un processo, in cui le delegazioni di alcune università europee ed americane si affrontano su uno specifico tema di diritto tributario internazionale e/o comunitario. Simulando tanto la fase scritta quanto il contraddittorio orale dinanzi all'autorità giudiziaria di un ipotetico Stato, le differenti squadre hanno proceduto, in questa edizione, all'analisi di un caso avente ad oggetto la ripartizione della sovranità in materia fiscale con riferimento ad un contribuente la cui attività lavorativa si prestava a molteplici qualificazioni nei diversi Stati coinvolti. Le soluzioni offerte a tale conflitto (reddito di lavoro autonomo, reddito di lavoro dipendente, reddito di artisti e sportivi, altri redditi), oltre ad una serie di problematiche in tema di residenza consentivano l'applicazione di diverse norme delle convenzioni contro le doppie imposizioni e, dunque, consentivano di approdare a diversi risultati in tema di ripartizione della potestà impositiva.

I paragrafi da 1 a 6 e da 6.2 a 6.5 del *Memorandum for the applicant* e i paragrafi da 1 a 5, i paragrafi 7, 7.2 e 7.3 del *Memorandum for the defendant* sono stati redatti da Simone Pietro Di Giacomo.

I paragrafi da 7 a 7.3 del *Memorandum for the applicant* e il paragrafo 6 del *Memorandum for the defendant* sono stati redatti da Lorenzo Locci.

I paragrafi da 8 a 8.2 del *Memorandum for the defendant* sono stati redatti da Romualdo Canini.

I paragrafi 6.1 e 8 del *Memorandum for the applicant* e i paragrafi 7.1 e 9 del *Memorandum for the defendant* sono stati redatti dalla da Benedetta Antinucci.

Il dott. Giuseppe Giangrande, il dott. Alessio Persiani, il dott. Federico Rasi e la dott.ssa Sarah Supino hanno assistito gli studenti nella preparazione dei lavori e nella successiva fase orale.

I lavori sono stati diretti dal Prof. Giuseppe Melis e dal Dott. Eugenio Ruggiero quali *team coach* della delegazione LUISS.

# MEMORANDUM FOR THE APPLICANT

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International & European Tax Moot Court  
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**MEMORANDUM FOR THE APPLICANT**

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### **III. Statement of Facts**

The taxpayer is Dario von Klempner, born in Rainbowland, also known as Super Dario for his past career as a kart racer, during which he won the prestigious International Moot Kart Competition. Unable to repeat his past victory, he ended his kart racing career in 2005. In the same year he married Countess Peach and later, together with her and their two kids, he settled in a gorgeous house in Rainbowland. Super Dario's private and social lifestyle featured on the cover of many magazines, since he was worldwide considered as a celebrity.

After the end of his career, the taxpayer was contacted by a company established in Gameland, named Noentiendo, whose object consisted in the development of computer games. The CEO of the company offered him a position as business and marketing consultant for the development of their car racing games and as an endorser of the product in order to attract more clients. The taxpayer accepted and signed the contract on 2 January 2012. He was not given an employment contract but a freelance contract, and the counterparty was not Noentiendo but Sonica, a company resident in Playland and not associated with Noentiendo.

The freelance agreement between Super Dario and Sonica had a duration of 1 year, renewable for equal periods, during which he would have to provide his services as consultant at the premises of the ten different offices of Noentiendo in Gameland, under its COO yearly plan. The taxpayer followed this plan completely, as well as the COO's instructions on how the services should have been performed. According to the plan, he had to rotate between the offices on a weekly basis, staying usually in the same room or moving from one room to another, depending on their availability. This was not a problem, since he had the possibility to provide his service through a laptop, with a strong internet connection, from the different apartments and hotels booked and paid by Noentiendo. He was also entitled to e-work for 1 week per month, which he did from a touristic location in Gameland. During the weekends, he usually came back home in Rainbowland, where he spent his free time going to the stadium to watch his football club, attending the Sunday Mass and also a great number of parties and social events.

From the end of March 2012, several reports in social magazines came out about Super Dario's drinking problems and bad behavior at nightclubs. Noentiendo communicated to Sonica that this

was not a good publicity for the company and on 15 June 2012 the latter terminated the contract with immediate effect. After moving back to Rainbowland on 20 June 2012, Super Dario returned to drink and mostly lived off paid appearances at nightclubs. On 31 October 2012, he decided to check into a rehab clinic in Gameland. The strict policy of the clinic was that patients enter voluntarily, but they can only leave it when are considered clean. He was released from there on 31 December 2012.

The tax authority of Rainbowland, after a random audit, contest the fact that Super Dario did not file his 2012 tax return there, hence it made a tax assessment against him. The taxpayer did not agree with the assessment and appealed to Rainbowland's Court, since he considers that no tax has to be paid in Rainbowland. In fact, in 2012 he was not a resident in Rainbowland and no income was sourced in this country. Even if the Court considered him a resident of the latter State, all of his income is sourced in Gameland and it fall under one of the allocation rules that allow cumulative taxation. As the chosen method for relief under the tax treaty between the two States is the exemption, he would not be taxed in Rainbowland anyway.

## IV. Issues

1. Residence issues:
  - 1.1. Double residence according to domestic tax law;
  - 1.2. Residence according to the DTC;
  - 1.3. Permanent home available;
    - 1.3.1. The term “home”;
    - 1.3.2. Availability;
    - 1.3.3. Permanency;
  - 1.4. Centre of vital interests;
  - 1.5. Habitual abode;
  - 1.6. Conclusions: Gameland as the residence State.
  
2. Gameland as the source State;
  - 2.1. Conclusions: the DTC shall apply in order to allocate taxing powers between Rainbowland and Gameland.
  
3. Article 23(a): exemption method.
  
4. On the applicability of Article 15:
  - 4.1. The use of more recent versions of the Commentary;
  - 4.2. The interpretation of the terms “employer” and “employment”: an autonomous approach;
  - 4.3. The application of the autonomous approach to the case at hand;
  - 4.4. The principle of effectiveness as a further argument;
  - 4.5. Conclusions: attribution of the taxing power to Gameland under article 15.
  
5. On the applicability of article 7:
  - 5.1. The concept of PE under article 5;
    - 5.1.1. The “disposal condition”;
    - 5.1.2. The fixed nature of the place of business;
    - 5.1.3. The “spatial delimitation theory”;
    - 5.1.4. The permanence test;
    - 5.1.5. The systemic importance of the “service PE” notion;

5.1.6. The existence of a PE in the case at issue;

5.2. Conclusions: the attribution of the taxing power to Gameland under article 7.

6. On the applicability of article 17:

6.1. Ambulatory approach in the interpretation of the new commentary;

6.2. The traditional definitions of the terms “entertainer” and “sportsman”;

6.3. The necessity of a Broader interpretation of the term “entertainer”;

6.4. The qualification of the taxpayer’s contract as an atypical endorsement contract;

6.5. The application of article 17 leads to the attribution of taxing powers to Gameland.

7. Conclusions.



## **V. Arguments.**

### **1. General remarks.**

1. This document aims at providing that the claims made by the Tax Administration of Rainbowland are unfounded; firstly, in respect of the attribution to the applicant of the tax residence of this State, secondly, with regard to the correct application of the distributive rules of the DTC which is in force between Rainbowland and Gameland.
2. The first considerations will concern the application of the internal tax rules on residence of Rainbowland and Gameland.
3. Once we have verified that a double residence shall be envisaged, it will be necessary to apply the DTC in force between Rainbowland and Gameland, whose provisions, contained in Art. 4(2), aim to resolve this sort of conflicts.
4. In this respect, we aim to demonstrate that the correct interpretation of the tie-breaker rules requires to consider the taxpayer as a resident for tax purposes solely in Gameland.

### **2. Residence according to Gameland and Rainbowland domestic law.**

5. In 2012 the taxpayer was a resident of Rainbowland and Gameland under their domestic law, since in both States he satisfied the criterion of the length of stay (more than 110 days)<sup>1</sup>.

### **3. Residence in Gameland according to the DTC.**

6. If the Court considered the taxpayer as resident both in Rainbowland and Gameland, since these States are bound by a DTC based on the OECD Model of 2003, it is necessary to have regard to Art. 4(2) of the Convention to solve the issue of residence. Art. 4(2) contains the tie-breaker rules which tip the balance of residence towards Gameland.

#### **3.1 Permanent home.**

7. First of all, under Art. 4(2) the residence State is the State where the individual has his permanent home. The permanent home test must be applied to each State separately, not taking

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<sup>1</sup> See annex.

into consideration whether or not the test is fulfilled in the other State<sup>2</sup>. For this reason, Art. 4(2) considers the case in which the individual has a permanent home available to him in both States or in neither of them.

8. Art. 4(2)(a) indicates three elements: home, permanence, availability<sup>3</sup>.
9. The home is the actual core of the test. We shall identify two different profiles: the first one, of an objective character, refers to the pure existence of a house of any kind (a villa, an apartment, a rented furnished room etc.)<sup>4</sup>, while the second one, a subjective element, aims at determining the personal link between the individual and the house considered<sup>5</sup>. This second aspect clearly results from the choice of using the term “home” instead of “house”, since the former differs from the latter for an additional subjective component. It has to be stressed that it is the subjective element which investigates whether a factual condition has been supported by the will of the individual concerned, i.e. a psychological element, purely internal to the mind of the individual. This entails that no direct proof of it can be achieved, because it could be verified only through indirect elements as circumstantial evidence.
10. The second element is permanence. The first reference for its correct interpretation is in the Commentary on Art. 4<sup>6</sup>, which states: “*the permanence of the home is essential; this means that the individual has arranged to have the dwelling available to him at all times continuously*”. From the expression “*has arranged to have*”, we infer that also in this case a subjective element is relevant; in other words, it is necessary that the individual aims at keeping the dwelling available to him for an undefined period, not occasionally but at all times continuously. Moreover, the element of permanence is directly related to the concept of availability in so far as it is required that it has to be continuous and not merely occasional<sup>7</sup>. Finally, according to the general principle of autonomy of the obligation arising in each tax period, this evaluation has to

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<sup>2</sup> E. STUART, *Art. 4(2) of the OECD Model Convention: Practice and Case Law*, in G. MAISTO, *Residence of individuals under tax treaties and EC Law*, IBFD, 2010, p. 185.

<sup>3</sup> Ibid, p. 184.

<sup>4</sup> OECD-Commentary on art. 4, paragraph 13; See also J. AVERY JONES ET AL., *Dual residence of individuals: the meaning of the expressions in the OECD model convention*, in *British tax review*, 1981, p. 15.

<sup>5</sup> K. VOGEL, *Klaus Vogel On double taxation conventions*, KLUWER, 1997, p. 248; See also, J. AVERY JONES ET AL., *Ibid.*, p. 15.

<sup>6</sup> OECD-Commentary on Art. 4, paragraph 13.

<sup>7</sup> K. VOGEL, *Ibid.*, p. 248.

be performed by reference to the facts occurred in the single tax period considered.

11. The third element is “availability”. As the jurisprudence stated, this requirement has to be considered from a purely factual point of view, since it disregards the existence of a juridical basis that justifies it<sup>8</sup>, even if the OECD Commentary considers within its examples only the hypothesis of ownership and rent. In fact, according to the Commentary, it is possible to infer that the permanent home test is an expansive test, therefore the use of words such as “belonging or rented” is merely illustrative of types of attachments between the individual and the dwelling<sup>9</sup>. As the scholars highlight, availability shall be regarded as an actual power of disposition on the house itself and it encompasses also the right of a tenant to determine occupancy of the dwelling<sup>10</sup>. Furthermore, it should not be given too much weight to the length of the individual's stay in determining whether a permanent home exists<sup>11</sup>.

12. Regarding the case at issue, all the three requirements were fulfilled in respect of the clinic's room where the taxpayer stayed when he was into rehab.

13. First of all, as we specified, the existence of a subjective element is relevant not only for the requirement of the home but also for the criterion of permanence. Regarding the clinic's room located in Gameland, this psychological element can be identified through an analysis carried out *ex ante*. The clinic's room was available to the taxpayer for an undefined period. In fact, at the beginning of his stay he was not aware of the total length of his future permanence there and he relied on the availability of the room at all times continuously. One should not overlook that the applicant had a long experience of a notorious hangover: before entering the clinic he never managed to actually overcome this problem, thus his stay reasonably would have been long and undefined. Instead, comparing the nature of his presence in Gameland in 2012 with the examples of “stay of short duration” provided for by the Commentary<sup>12</sup>, we see that they radically differ, because they refer to stays which take place mainly within the context of travels (business travels, holiday travels) whose main feature is predetermined duration. Therefore, we

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<sup>8</sup> See for instance, Conseil d'État, case N°: 300733, 11 December 2009, Report from ERIC ROBERT, IBFD Research Associate; see also: Treaty between France and UK – French Administrative Supreme Court rules on "permanent home" tie-breaker rule, in TNS Online, 2010, 4; See also M. GRANON, as quoted in G. MAISTO, *Ibid.*, p. 530.

<sup>9</sup> Argument deriving from M. DIRKIS as quoted in G. MAISTO, *Ibid.* p. 234.

<sup>10</sup> K. VOGEL, *Ibid.* p. 248. See also N. MESSAGE, as quoted in G. MAISTO, *Ibid.* p. 350.

<sup>11</sup> J. AVERY JONES ET AL., *Ibid.*, p. 116.

<sup>12</sup> OECD-Commentary on Art. 4, paragraph 13.

conclude that the taxpayer did not regard the clinic as a simple house but rather as a permanent home in Gameland.

14. Also the requirement of availability shall be deemed to be satisfied; indeed, when he checked into rehab the taxpayer could be associated to a tenant and, as a tenant, he had the right to determine occupancy of the dwelling.
15. On this ground, since the three elements that belong to the concept of “permanent home” were fulfilled in respect of the clinic’s room, a “permanent home available” shall be deemed to exist in Gameland.
16. The Court may reject the argument based on the subjective element and, in order to evaluate the existence of a permanent home, it may compare the length of stay in the clinic, on the one hand, and the length of stay in Rainbowland, on the other. However, neither Art. 4 of the DTC nor the Commentary clarify the length which is sufficient as to deem a home as permanent. In this respect, Art. 5(3) of the DTC would be helpful. It establishes that “*a building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months*”. Hence, it is possible to infer that the OECD regards a period of 12 months as sufficient for the establishment of a close relation between the person and a Contracting State<sup>13</sup>.
17. Sharing this reasoning, the conclusion would be that in 2012 the taxpayer did not have a permanent home either in Rainbowland, since his stay there was shorter than 12 months. In this case the applicant would not have a permanent home in either State and, under Art. 4(2)(b), it would be necessary to directly apply the habitual abode test.
18. As a third option, if the Court reasoned that in 2012 the taxpayer had a permanent home in both States, under Art. 4(2)(a) it would be necessary to identify the State which applicant’s personal and economic relations (centre of vital interests<sup>14</sup>) are closer to.

### 3.2 Centre of vital interests.

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<sup>13</sup> A. RUST, as quoted in G. MAISTO, *Ibid.*, p. 386.

<sup>14</sup> Hereinafter CVI.

19. The CVI has to be placed in the State where the individual has his strongest personal and economic ties, but it is necessary to analyse separately the personal and economic interests; however, a global evaluation is eventually required<sup>15</sup> in order to detect the only one CVI that may exist<sup>16</sup>.
20. Economic interests are those located in a State through a source of income. If they are present together with a permanent home which is also functional to attend to those sources of income (as it happened in the case at issue), this can show special economic interests of the individual concerned with the State<sup>17</sup>.
21. On the other hand, the notion of personal interests is an all-encompassing one, since it does not only cover social relations with other individuals, but also with impersonal or superindividual entities<sup>18</sup> (for instance a vacation). Furthermore, case law in this area includes an examination of factors such as where the individual places his medical insurance<sup>19</sup> or where he carries out his leisure activities<sup>20</sup>.
22. As regards economic interests, they are clearly attached to the territory of Gameland. In 2012, the taxpayer performed his professional activities only in that State. Conversely, his personal relations were more complex, because they were distributed between the two States: on the one hand, he had his family in Rainbowland, on the other hand in 2012 he lived for about six months in Gameland, one week per month he did e-work from a touristic location in Gameland (therefore he carried out some leisure activity there) and in this State he placed his medical insurance. Hence, we can infer that he preserved personal and social ties with Gameland as well.
23. We shall now proceed, according to the OECD Commentary, to a global evaluation of all the elements. The analysis of the facts shows that the taxpayer's economic interests are located in Gameland. Furthermore, since he worked there for almost one year, he did some vacation there and he went into rehab for two months, he realistically had in Gameland also an important part

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<sup>15</sup> OECD-Commentary on Art. 4, paragraph 15.

<sup>16</sup> P. BAKER, *The Expression "Centre of Vital interests" in Art. 4(2) of the OECD Model Convention*, in G. MAISTO, *Ibid.*, p 172; K. VOGEL, *Ibid.*, p. 249.

<sup>17</sup> K. VOGEL, *Ibid.*, p. 250.

<sup>18</sup> OECD-Commentary on Art. 4, paragraph 15.

<sup>19</sup> See the decision of the Appeals Court in Amsterdam, Hof Amsterdam, 12 January 2001, LJN.

<sup>20</sup> P. BAKER, *Ibid.*, p. 177.

of his personal interests.

24. Thus, the CVI shall be considered to exist and to be located in Gameland, because, on the one hand, the economic interests were exclusively connected with this State, but, on the other hand, the personal interests were distributed between the two States. Using the argument of the dispersion of personal interests to affirm that the CVI cannot be determined would imply giving preference to personal interests over economic ones.

25. This possibility is denied by several courts, like the Conseil d'Etat<sup>21</sup> and the Spanish Supreme Court<sup>22</sup>, which do not recognize any priority. Furthermore, the interpretation consisting in giving preference to personal relations is not supported by the text of the Convention, which refers to both the kinds of interests without setting them into a hierarchy. The Commentary itself, in stressing the importance of “personal acts”, does not endorse the aforementioned interpretation: personal acts could either relate to economic activities or to personal relations<sup>23</sup>. Moreover, the consideration that the CVI is unique for each individual makes it even less acceptable the idea that some interests may prevail over others, since they all participate in fulfilling a single requirement.

26. One could argue that also the history of Art. 4(2) shows the willing of the OECD to give preference to personal relations over economic ones. In fact, the first two drafts of this provision, issued in 1957 by the OEEC (which was superseded by the OECD in 1961), clearly tip the balance toward this direction. However, it should be noted that finally, in 1958, at the meeting of the Fiscal Committee it was agreed to replace “personal relations” by “personal and economic relations”<sup>24</sup>. As it is clear, this has been a substantive change to the relevant provision and, under Art. 32 of the Vienna Convention on the Law of Treaties, it can be used as a supplementary means of interpretation in order to clarify that personal and economic relations have in principle an equal weight.

27. As a conclusion, since personal and economic interests have an equal weight and, while the

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<sup>21</sup> CE 17 December 2003, No. 241920, RJF 3/04 No. 297, BDCF 3/04, No. 41.

<sup>22</sup> Judgment of the Supreme Court issued on 4-4-2005 and 4-7-2006.

<sup>23</sup> P. BAKER, *Ibid.*, p. 178.

<sup>24</sup> J. SASSEVILLE, *History and interpretation of the Tiebreaker Rule in art. 4(2) of the OECD Model Tax Convention*, in G. MAISTO, *Ibid.*, p. 161.

former are scattered between the two States, the latter are exclusively connected with Gameland, the CVI must be considered to exist in this State.

### 3.3 Habitual abode.

28. We shall apply this tie-breaker rule in two cases: when the CVI cannot be determined and when the permanent home is considered to exist in neither of the States.
29. In relation to the first hypothesis, the Commentary on Art. 4 establishes that it has to be taken into account “*the State where he [the taxpayer] stays more frequently*”<sup>25</sup>. Many Courts and administrations interpret the term “*State where he stays more frequently*” as simply requiring a comparison between the individual’s length of stay in each State<sup>26</sup>.
30. In this respect, two leading decisions were issued in the Canadian *Allchin v. The Queen* case and in the American *Stephen Podd et al. V. Commissioner of Internal Revenue* case. These two similar decisions suggest that the habitual abode test is simply a comparison of day counts<sup>27</sup> and the same meaning was adopted by the French *Conseil d’Etat*<sup>28</sup> when interpreting the concept of “usual place of residence”, which is usually used in French Treaties instead of the term “habitual abode” (but it has the same characteristics<sup>29</sup>).
31. As it is clear, in 2012 the requirement at issue was satisfied in Gameland. The comparative approach, which we suggest the Court to follow, leads to the necessary conclusion that the State where the habitual abode is located is the one in which the length of stay is longer, even though there is only a difference of a few days, like in our case<sup>30</sup>. Furthermore, even if the taxpayer went from one hotel or apartment to another, as the Commentary states it is necessary to have regard to stays made “not only at the permanent home [...] but also at any other place in the same State”<sup>31</sup>.

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<sup>25</sup> OECD-Commentary on art. 4, paragraph 17.

<sup>26</sup> J. SASSEVILLE, *Ibid.*, p. 165; A. BELLENS, as quoted in G. MAISTO, *Ibid.* p. 293; A. RUST, *Ibid.*, p. 388; As regards jurisprudence, see two Canadian decisions: *Allchin v. The Queen* (8 April 2005) and *Yoon v. The Queen* (22 July 2005); the same conclusions were reached in the American case *Podd v. Commissioner*, (1998) Tax Ct. Memo LEXIS 414, as quoted in *Yoon v. the queen*.

<sup>27</sup> E. STUART, *Ibid.*, p. 190.

<sup>28</sup> CE 26 January 1990, No. 69853, Renck.

<sup>29</sup> J. SASSEVILLE, *Ibid.*, p. 166.

<sup>30</sup> See annex.

<sup>31</sup> OECD-Commentary on Art. 4, paragraph 17.

32. In the second case where it is necessary to apply the habitual abode test (permanent home in neither State), the Commentary<sup>32</sup> provides that “*in this case also all stays made in a State must be considered without it being necessary to ascertain the reasons for them*”.
33. In this case as well it shall be concluded that in 2012 the applicant had his habitual abode in Gameland, since the length of the stay in Gameland was longer than the amount of days spent in Rainbowland<sup>33</sup>. As a result, we suggest the Court to consider the taxpayer as a resident of Gameland.
34. To sum up, all the tie-breaker rules analysed above tip the balance of residence towards Gameland; therefore, the taxpayer shall be taxed there on his worldwide income.
35. Even if the applicant was considered a resident of Rainbowland, all of the income he received should be considered as sourced in Gameland and should fall under one of the allocation rules, contained in the Convention, which attribute the right to tax to the latter State.

#### **4. Gameland as the source State.**

36. According to the so-called “source principle”, a country considers as taxable income all the profits which arise within its jurisdiction, regardless of the residence of the taxpayer<sup>34</sup>. From the facts of the case we know that Gameland applies this principle. In this paragraph, we will demonstrate that the applicant’s income is considered as taxable under Gameland’s domestic law, since it arose within the jurisdiction of this State. In 2012 there was a strong economic attachment between the taxpayer and Gameland that was sufficient to qualify the latter State as the source State.
37. Since income can arise in a myriad of forms, it is not possible to have a single definition of “source” concerning all cases. Therefore, an item of income has first to be characterized into a specific category. Then it is necessary to find the appropriate source rule.

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<sup>32</sup> OECD-Commentary on Art. 4, paragraph 18.

<sup>33</sup> See annex.

<sup>34</sup> See A. RUSSO, *Formulary Apportionment for Europe: An Analysis and a Proposal*, in *Intertax*, 2015, 33, p. 12.



38. In first instance, it is clear that under Gameland's domestic law the remuneration received by the applicant has to be qualified as income from employment. In fact, this State adopts a substantial approach and not a formal one when interpreting a contractual relationship: an employment relationship is considered to be existent, regardless of the signing of a contract, if there is subordination, the acceptance of instructions from a superior, the fulfilment of a work schedule and the exercise of the activity at the premises of the enterprise. With respect to the relationship between the applicant and Noentiendo, all these requirements were fulfilled in 2012.
39. In second instance, Gameland's tax system considers this State as the source State, since in 2012 the applicant actually performed his activity within its territory. In fact, in relation to income from employment, Gameland's tax law identifies the source State with the State in which the activity is actually exercised, regardless of the fact that the remuneration is formally paid by a legal person residing in another State. This conclusion results from the circumstance that, when Gameland signed the DTC with Rainbowland, it did not make any reservation to the Commentary on Art. 15, according to which, in respect of income from employment, the source State is the State where "*the employee is physically present when performing the activities for which the employment income is paid*"<sup>35</sup>. Beyond this consideration, it is possible to affirm that this source rule is endorsed by International tax law: in fact, it is contained not only in the Commentary on the OECD Model, but also in the Commentary on the UN Model<sup>36</sup>.
40. Hence, under Gameland's tax system the remuneration received by the applicant is to be considered as income from employment and as sourced in Gameland itself. Considering Rainbowland as the residence State and Gameland as the source State requires us to apply the DTC concluded in 2003 in order to establish which State has the taxing power. We will demonstrate that the relevant provisions of the DTC attribute the taxing power to Gameland.

#### **5. Art. 23 (A) of the DTC.**

41. Art. 23A(1) provides that "*Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other*

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<sup>35</sup> OECD-Commentary on Art. 15, paragraph 1.

<sup>36</sup> UN-Commentary on Art. 15, paragraph 1.

*Contracting State, the first-mentioned State shall [...] exempt such income or capital from tax”.*

42. Therefore, in case the applicant was considered a resident of Rainbowland, it would be necessary to specify under which provision of the DTC his income may be taxed in the other Contracting State (namely Gameland), in order to conclude that the State of residence has to grant the exemption.

## **6. On the applicability of Art. 15 of the DTC.**

43. The provision at issue must be identified in Art. 15 of the DTC, which refers to taxation of income from employment.

44. We will demonstrate that Art. 15, using more recent versions of Commentaries, is applicable to the case at issue. In fact, it refers to an international, common understanding of the terms “employment” and “employer”, which is independent from the interpretation of these concepts under the domestic laws of the Contracting States.

### **6.1. The possibility to use more recent versions of the Commentaries.**

45. Before dealing with the applicability of Art. 15, it is necessary to specify that it is advisable to follow a dynamic interpretation of the Commentary. By virtue of this approach, new versions of the Commentaries become applicable if they reflect a mere specification, clarification or updating of the Treaty, instead of a substantive change. This conclusion is based on the fact that clarificatory revisions of the Commentaries reflect the consensus of the OECD member countries as to the proper interpretation of existing provisions of the Treaty and their application to specific situations, as also the introduction of the current Commentary specifies<sup>37</sup>.

46. This consideration does not eliminate the need for examining in each single case whether the new version only clarifies treaty law or whether it is an attempt to change it. As for the update of the commentary on Art. 15, it is necessary to look back at the historical development regarding the provisions dealing with the so-called hiring-out of labour. It occurs when a local

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<sup>37</sup> M. LANG and F. BRUGGER, *The role of the OECD Commentary in tax treaty interpretation*, in Australian tax forum, 2008 p. 95.

employer (user company) employs foreign labour force for a short period through an intermediary company (hiring out company). The latter is established abroad, it purports to be the employer and hires the labour out to the user company<sup>38</sup>. While the 2003 Commentary referred only to abusive hiring-out of labour practices, in 2010 the Commentary was amended to include also *bona fide* short-term assignments, which imply the same conduct but without any indication of abuse. This amendment was requested since the Discussion draft of 2004<sup>39</sup>.

47. Since the intention to modify the Commentary on Art.15 raised in 2004, it is self-evident that the update was an attempt to clarify an ambiguously written Commentary. Therefore, in this case the amendments simply clarified the text and the 2010 version of the Commentary can be used as means of interpretation.

48. There is another argument, supported by scholars<sup>40</sup> and international courts<sup>41</sup>, in favour of this ambulatory interpretation. A tax treaty is based on the circumstances existing at the time it was concluded and often refers to the national law applicable at that time for its interpretation. However, it should be noted that national law is continually changing, especially in the area of taxes. In addition, technological developments, political insights, national tax policy and international and supranational legal developments are constantly on the move. A treaty interpretation based on references to provisions, insights or assumptions which are obsolete, no longer applicable, or even no longer permissible, may be extremely ineffective<sup>42</sup>. The more period of time has elapsed since the treaty was concluded, the more ineffective an obsolete interpretation risks to be.

49. The logic consequence of this reasoning is that, in order to interpret Art. 15 and to evaluate its applicability to the case at hand, reference must be made to the 2010 version of the Commentary.

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<sup>38</sup>S. GOEYDENIZ, *IFA Research Paper: Tax Implications on International Hiring-Out of Labour/ Hiring-Out of Labour - still the poor relation in double tax conventions?*, IBFD, 2010, p. 3.

<sup>39</sup> OECD, *Revised Draft Changes to the Commentary on Paragraph 2 OF ARTICLE 15*, 12 March 2007.

<sup>40</sup> HUGH J. AULT, *The Role of the OECD Commentaries in the Interpretation of Tax Treaties* Intertax 1994 p. 144; P. J. WATTELAND O. MARRES, *The Legal Status of the OECD Commentary and Static or Ambulatory Interpretation of Tax Treaties* 2003 IBFD p. 222.

<sup>41</sup> *Johansson v United States*, 336 F2d 809 (5th Cir 1964); *Aiken Indus., Inc. v Commissioner*, 56 TC 925, (1971); *Northern Indiana Public Service Company v Commissioner*, 115 F3d 506 (1997).

<sup>42</sup> D. M. BROEKHUIJSEN, KOEN M. VAN DER VELDE, *The Retroactive Effect of Changes to the Commentaries on the OECD Model p.1.*

## 6.2. The interpretation of the terms “employer” and “employment”.

50. The possibility to use more recent versions of the Commentaries makes it clear that an interpretation of the terms employer and employment, based on substance over form rules, shall apply, despite the formal approach followed by Rainbowland’s domestic law.
51. The contract signed by the taxpayer in 2012 was formally a “freelance agreement”, therefore one could argue that it is not possible to apply Art. 15, since he was a self-employed and his situation does not fall under the scope of the provision at issue.
52. Having regard to the first paragraph of this article, its scope covers the case in which the income is derived “*by a resident of a Contracting State in respect of an employment*”. Neither the Convention in force between Rainbowland and Gameland nor the OECD Model provide for a definition of the term “employment”. Thus, Art. 3(2) of the DTC shall apply<sup>43</sup>, which establishes that “*As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State*”. Therefore, it is necessary to refer to the meaning that the term “employment” has under Rainbowland’s domestic law, since this State is applying the Convention.
53. Although the latter State adopts a formalistic approach on this matter, it should be noted that Art. 3(2) of the DTC allows the reference to the domestic law of the State applying the Convention “*only if the context does not require an alternative interpretation*”<sup>44</sup>. Therefore, before concluding that Art. 15 is not applicable since Rainbowland’s domestic law adopts a formalistic approach, it is necessary to evaluate whether or not, as regards the meaning of the terms “employment” and “employer”, the “context” requires an interpretation other than that based on

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<sup>43</sup> See H. LOUKOTA, *Vermeidung von Irrwegen bei der DBA-Auslegung*, Steuer & Wirtschaft International (1998): 559 (559 et seq.); see also F POTGENS, *Income from International Private Employment – An Analysis of Article 15 OECD Model* (2006), 292 et seq.; B. PEETERS, ‘Article 15 of the OECD Model Convention on “Income from Employment” and its Undefined Terms’, European Taxation (2004): 72 et seq.; apparently also G. PEZZATO, *The Meaning of the Term “employment” under article 15 of the OECD Model Convention*, in Taxation of Employment Income in International Tax Law, eds d. hohenwarter & v. metzler (2009), 49 (65 et seq.). On this issue in greater detail: J. AVERY JONES et al., *The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD-Model*, British Tax Review (1984): 14 et seq. and 90 et seq.; J. AVERY JONES, *Qualification Conflicts: The Meaning of Application in Art. 3(2) of the OECD Model*, in Festschrift für Karl Beusch, eds Heinrich Beisse, Marcus Lutter & Heribald Närgel (1993), 43 et seq.; J. AVERY JONES, *The “One True Meaning” of a Tax Treaty*, BIFD (2001), p. 220.

<sup>44</sup> OECD-Commentary on Art. 3, paragraph 12.

the reference to Rainbowland's domestic law.

54. Neither the Convention nor the Commentary provide a clear definition of what the term “context” means. However, the Commentary provides a limited guidance, since it establishes that the context is determined also by “*the legislation of the other Contracting State*”<sup>45</sup>. For this reason, if the domestic law of the other Contracting State gives a different meaning of the controversial term, this would be a case in which the context otherwise requires.
55. Another reference to the “context” is contained in the Vienna Convention on the Law of Treaties, signed by Rainbowland and Gameland. Art. 31(1) of the VCLT provides that “*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 provision contains the fundamental principle of the “textual approach”, adopted by the International Court of Justice as well<sup>46</sup>. This principle also requires that the ordinary meaning to be given to the terms of the treaty is to be determined not in isolation, but in the context of the treaty and in the light of its object and purpose<sup>47</sup>. In this respect, Art. 31(2) VCLT provides that, for the purpose of the interpretation of a treaty, the context shall comprise, in addition to the text of the treaty, “*Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions*”.
56. A subsequent agreement can be identified in a new version of the Commentary on the OECD Model Convention which simply specifies the correct meaning of an existing provision. In fact, according to the introduction of the 2014 Commentary, changes or additions to the Commentaries “*reflect the consensus of the OECD Member countries as to the proper interpretation of existing provisions and their application to specific situations*”.
57. From what it is said above, in order to establish whether or not “the context” requires an interpretation of the terms “employment” and “employer” other than that based on Rainbowland’s domestic law, it is necessary to refer both to Gameland’s domestic law and to the object and purpose of the DTC (which can be inferred from more recent versions of

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<sup>45</sup> Ibid.

<sup>46</sup> F. ENGELN, *Interpretation of Tax Treaties under International Law*, IBFD, 2004, p. 83.

<sup>47</sup> Ibid., p. 112.

Commentaries).

58. First of all, Gameland adopts a substantial approach and not a formal one when interpreting the term employment. According to its domestic law, an employment relationship is considered to be existent if there is subordination, the acceptance of instructions from a superior, the fulfilment of a work schedule and the exercise of the activity at the premises of the enterprise. Therefore, a contrast between the meaning of employment adopted by Gameland and Rainbowland arises.
59. Secondly, a reference must be made to the current Commentary. More specifically, an autonomous meaning of the terms “employment” and “employer”, based on an international, common understanding of them, arises from the part concerning art. 15: as we mentioned, its paragraphs 8 and sequent deal with *bona fide* short-term assignments and international hiring-out of labour.
60. In these cases, the issue is whether or not the worker, notwithstanding the fact that he signed a contract with the intermediary company, has to be considered in an employment relationship with the user company (that in this hypothesis would be regarded as the real employer). When addressing this problem, the Commentary provides for an autonomous meaning of the terms “employment” and “employer”<sup>48</sup>. In fact, a reference to the domestic law of the State applying the treaty is recommended, in order to determine whether or not an individual is employed in the context of the international hiring-out of labour, but only under the condition that the conclusion does not contradicts objective criteria (“*The conclusion that, under domestic law, a formal contractual relationship should be disregarded must, however, be arrived at on the basis of objective criteria*”<sup>49</sup>).
61. From these words it derives that the OECD presupposes an autonomous notion of the concepts

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<sup>48</sup> See M. LANG, *Steuer & Wirtschaft International* (1998): 511 et seq.; See G. COULOMBE, *General Report*, in *Cahiers de Droit Fiscal International* Vol. 67b, Taxation of payments of non-residents for independent personal services, ed. International Fiscal Association (1982), 39 et seq.; R. PROKISCH, in *Double Taxation Conventions*, ed. K. VOGEL (1997), Art. 15 MN 16 et seq.; M. LANG, U. ZIESERITSCH, *Der Begriff der unselbständigen Arbeit nach Art. 15 OECD-MA*, in *Arbeitnehmer im Recht der Doppelbesteuerungsabkommen*, eds W. GASSNER, M. LANG, E. LECHNER, J. SCHUCH & C. STARINGER (2003), 31 (46 et seq.); P. CSOKLICH & O. GUNTHER, *Visiting Academics in Double Tax Treaties*, in *INTERTAX*, 2011, pag. 579.

<sup>49</sup> OECD-Commentary on Art. 15, paragraph 8.11.

of “employment” and “employer”, because otherwise it would never be possible to tell whether a domestic law provision contradicts specific objective criteria<sup>50</sup>. Such an autonomous approach shall be adopted by the residence State as well and should prevail over any divergent domestic law.

62. As regards this autonomous meaning, the Commentary establishes that two important characteristics of an employment relationship must be fulfilled; these are the so-called “control and integration in the master’s business”<sup>51</sup>. Firstly, it is necessary that the individual renders his services “*to a person other than the employer and that person, directly or indirectly, supervises, directs or controls the manner in which those services are performed*” (control test). Secondly, it is required that “*those services constitute an integral part of the business activities carried on by that person*”<sup>52</sup> (integration test).
63. Regarding the control test (namely the element of subordination), the Commentary provides some criteria that should help to solve this issue<sup>53</sup>, such as “*who has the authority to instruct the individual regarding the manner in which the work has to be performed; who controls and has responsibility for the place at which the work is performed; who puts the tools and materials necessary for the work at the individual’s disposal; who determines the holidays and work schedule of that individual*”<sup>54</sup>. Concerning the integration test, the Commentary states that “*a key consideration will be which enterprise bears the responsibility or risk for the results produced by the individual’s work*”<sup>55</sup>. In hiring-out of labour cases, the intermediary usually has responsibility only as to the provision of the labour itself and bears neither responsibility nor risk as regards the result of the work<sup>56</sup>.
64. The autonomous approach when interpreting the term employment is endorsed by the large

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<sup>50</sup> See P. CSOKLICH & O. GÜNTHER, *Visiting Academics in Double Tax Treaties*, in INTERTAX, 2011, pag. 580; E. BURGSTALLER, *Ibid.*, p. 129.

<sup>51</sup> D. WEBER, S. VAN WEEGHEL, *The 2010 OECD Updates Model Tax Convention & Transfer Pricing Guidelines A Critical Review*, in Kluwer Law International, 2010, p. 126; S. GOEYDENIZ, *Ibid.* p. 20.

<sup>52</sup> 2014 OECD-Commentary on Art. 15, paragraph 8.3

<sup>53</sup> See P. CSOKLICH & O. GÜNTHER, *Visiting Academics in Double Tax Treaties*, in INTERTAX, 2011, pag. 580.

<sup>54</sup> 2014 OECD-Commentary on Art. 15, paragraph 8.13.

<sup>55</sup> 2014 OECD-Commentary on Art. 15, paragraph 8.12.

<sup>56</sup> S. GOEYDENIZ, *Ibid.*, p. 9; IFA, *Taxation Issues Relating to the International Hiring-out of Labour* (1984), para. 4.

majority of the doctrine as well as the jurisprudence<sup>57</sup>. On the contrary, legal doctrine and doctrinal articles that support the concept of formal employer are quite rare<sup>58</sup>.

65. In conclusion, the Commentary as well as the view of the doctrine and the jurisprudence show that the object and purpose of Art. 15, concerning the interpretation of the terms “employment” and “employer”, is to outline a concept which is autonomous from the domestic laws of the Contracting States and which is based on substance over form rules.

66. Therefore, if the domestic law of a Contracting State normally adopts a formal approach which contradicts this autonomous meaning, the “context otherwise requires” clause<sup>59</sup> shall be applied<sup>60</sup>: this means that the autonomous meaning replaces any divergent domestic law.

### **6.3. The applicability of Art. 15 to the case at issue.**

67. Applying the autonomous approach to our case, it is clear that an employment relationship shall be recognized between Noentiendo and the taxpayer, since both the control and integration tests are fulfilled.

68. In fact, the applicant worked under the strict direction and supervision of Noentiendo; he exercised his activities at Noentiendo’s offices, therefore the latter company controlled and had responsibility for the place at which the work was performed; Noentiendo put the tools and materials necessary for the work (such as a laptop and a fast internet connection) at the individual’s disposal; the COO of Noentiendo determined the holidays and work schedule of the applicant. Furthermore, it should be noted that the applicant’s salary was substantially paid by Noentiendo, even though it was simply paid out by Sonica.

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<sup>57</sup> As regards the Dutch Jurisprudence, see the Slaughterhouse case (DK: Ht ,17 Apr. 2012, 257/2010/SKM 2012.462.HR, Parter H1 K/S vs. Skatteministeriet, Tax Treaty Case Law IBFD); The Netherlands Supreme Court, case number 38.850, case number 38 950, case number 39.535, case number 39.710, case number 40.088, case number 07/00361 and judgmentS of 1 December 2006, BNB 2007/75–79.; Concerning the German jurisprudence, see for example the German Federal Tax Court, case number I R 63/80.; the German Tax Court of First Instance, case number I 6/96 and case number 1 K 1195/99; Withe respect to the Swedish jurisprudence, see for example the 2001 *Brynäs Ice Hockey Association* case, delivered by The Swedish Supreme Administrative Court, RÅ 2001 ref. 50; concerning the UK jurisprudence, an important case is *The Kljun case*, UK: FTT, 10 Aug. 1012, Tomislav Kljun v. Commissioners for Her Majesty’s Revenue and Customs, TC/2010/04825, [2011] UKFTT 371 (TC), Tax Treaty Case Law IBFD.

<sup>58</sup> BRUGGER F., ECKER T., KOLOZS B., KOPPENSTEINER F., PAUN C., STÜRZLINGER B. *Vienna University Conference 2007 – Source versus Residence – The Allocation of Taxing Rights in Tax Treaty Law* (2008) Intertax, Volume 36, 5th Issue, 2008. Cit: [Brugger *et al.* (2008)].

<sup>59</sup> Art. 3(2) of the DTC.

<sup>60</sup> See P. CSOKLICH & O. GÜNTHER, *Ibid.*, pag. 579.



69. Secondly, the taxpayer's services constituted an integral part of Noentiendo's business activities. As we have already mentioned, according to the Commentary a benchmark of the integration test is the fact that the real employer bears the responsibility or risk for the results produced by the individual work. It should be noted that the applicant provided guidance to the programmers on how to make the races more realistic (he also had basic notions of programming). Thus, any negative results of his work (such as a computer game that, by virtue of the applicant's experience, is too violent and cannot be sold to children) would have involved the responsibility of Noentiendo itself. The integration test was consequently fulfilled as well.

70. In conclusion, we suggest the Court to consider that an employment relationship was existent in 2012 between the taxpayer and Noentiendo. In consequence, all income he received is to be considered as income from employment and Art. 15 shall apply.

#### **6.4. The principle of effectiveness as a further argument.**

71. There is an overriding reason that prevents Rainbowland from applying formal criteria and from considering Sonica as the real employer: such a reason is the general principle of effectiveness.

72. The latter is based on two individual subprinciples. First of all, all individual treaty provisions must be considered to have been drafted for the purpose of achieving a specific effect, so that every interpretation that results in a treaty provision becoming a dead letter is contrary to the principle at issue. Secondly, it must be considered that a treaty as a whole is based on a specific objective, whereby any interpretation that prevents it from being attained has to be avoided<sup>61</sup>.

73. The International Law Commission argues that if a treaty provision is open to two different interpretations, whereby one of them makes the effective implementation of a treaty possible while the other does not, then the principle of good faith, applicable under Art. 31(1) of the

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<sup>61</sup> G. FITZMAURICE, *The Law and Procedure of the International Court of Justice: Treaty Interpretation and Certain Other Treaty Points*, British Yearbook of International Law 28 (1951): 19, Oxford: Oxford University Press, 1951; See also H. LAUTERPACHT, 'Restrictive Interpretation and the Principle of Effectiveness in the Interpretation of Treaties', British Yearbook of International Law 26 (1949): 48, Oxford: Oxford University Press, 1949; See also F. PÖTGENS, J.DEHEER, *The International Public Law Effectiveness Principle and Qualification Conflicts from a Dutch Perspective*, in INTERTAX, 2012, p. 60.

VCLT, demands the first interpretation to be followed<sup>62</sup>. Art. 31(1) therefore forms the basis for the principle of effectiveness. This article requires Contracting States to interpret treaty provisions in good faith and in accordance with the context and spirit of the treaty, a position that was confirmed by the International Court of Justice<sup>63</sup>.

74. As regards tax treaties, the spirit can be sufficiently established. The objective is the avoidance of double taxation. Art. 15 of the OECD Model, distributing the taxing power between the contracting States, clearly mirrors this purpose. Hence, when interpreting this article and evaluating its applicability, the principle of effectiveness imposes to adopt an interpretation which is in line with the aim of elimination of double taxation.

75. In the case at issue, the State of residence has a formal approach and it is the first State that applies the Convention. On the other hand, the State of source has a substantial approach and it has not applied the Convention yet. Therefore, from the State of residence perspective this situation may lead to two different scenarios<sup>64</sup>.

76. First of all this State, following his formal approach, may interpret the terms employer and employments independently, namely not having regard to what would be the interpretation of the other State. In this hypothesis, it would conclude for the non applicability of Art. 15 and it would levy tax under another allocation rule. Secondly, despite its formal approach, the State of residence may interpret these terms following the substantial qualification which the source State would adopt and which can be inferred from the current Commentary. In this case, the State of residence would apply Art. 15, it would recognize that the latter attributes the taxing power to the source State and it would grant the exemption under Art. 23A.

77. Pursuant to the ICJ case law, the interpretation that is most appropriate for avoiding double taxation must be given precedence<sup>65</sup>. As it is clear, such an interpretation is the second one, because the first one would cause the State of residence, on the one hand, to tax the individual

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<sup>62</sup> Third Report on the Law of Treaties (ILC Yearbook vol. 2), p. 219, United Nations 1966; See also R. GARDINER, Treaty Interpretation (Oxford: Oxford University Press, 2008), 160.

<sup>63</sup> See, for instance, the Libya v. Chad case (ICJ 3 Feb. 1994, Territorial Dispute (Libyan Arab Jamahiriya v. Chad)), the Injuries case (ICJ 11 Apr. 1949, Reparation for Injuries Suffered in the Service of the United Nations and the Corfu case (ICJ 9 Apr. 1949, Corfu Channel (United Kingdom of Great Britain and Northern Ireland v. Albania)).

<sup>64</sup> Frank P.G.Pötgens & Lucas J.deHeer, *ibid.*, in INTERTAX, 2012, p. 61.

<sup>65</sup> F. PÖTGENS & Lucas J.DE HEER, *ibid.*, in INTERTAX, 2012, p. 61.

according to another article of the DTC (for example Art. 7) and the State of source, on the other hand, to tax the individual under Art. 15<sup>66</sup>.

78. One could argue that there is no reason for concluding that it is Rainbowland that would have to follow Gameland's approach and not vice versa. However, this is inferred from the Commentary on Art. 23 as well<sup>67</sup>, although it refers to the case in which the State of source has already applied its own qualifications. This conclusion is supported by the Dutch *Slaughterhouse case*<sup>68</sup>, which was very similar to the case at hand and where the Dutch Supreme Court considered the user company (corresponding to Noentiendo) and not the intermediary company (corresponding to Sonica) as the real employer, upon the consideration that the domestic law of the State of source, as opposed to that of the State of residence, had a substantial approach when interpreting the terms employer and employment<sup>69</sup>.

79. Therefore, from this reasoning it derives that the principle of effectiveness constitutes a further argument to adopt a substantial approach and to consider Art. 15 as applicable to the case at hand.

### **6.5. The allocation of the taxing power under Art. 15 of the DTC.**

80. Art. 15(1) attributes the right to levy taxes to the State where the activity is actually exercised<sup>70</sup>. Therefore, if Dario was considered a resident in Rainbowland, under Art. 15(1) he would have to be taxed in Gameland.

81. Art. 15(2), introducing an exception to the aforementioned rule, attributes the right to levy taxes to the State of residence if three conditions are fulfilled. As regards the first condition, it was not fulfilled in the case at state. Within the taxable year concerned the taxpayer was present in the other State (Gameland) for periods exceeding in the aggregate 183 days. In addition, the second condition cannot be deemed being fulfilled as well. In fact, the Court could not consider Sonica as the real employer, after having concluded for the general applicability of art. 15: the choice

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<sup>66</sup>VAN RAAD, KEES. *Tax Treaty Interpretation and Application* (2002) published in *International and Comparative Taxation - Essays in Honour of Klaus Vogel*, Kluwer Law International, Bodmin, 2002, p. 223.

<sup>67</sup> OECD-Commentary on Art. 23, paragraph 32.3

<sup>68</sup> DK: Ht ,17 Apr. 2012, 257/2010/SKM 2012.462.HR, Parter H1 K/S vs. Skatteministeriet, Tax Treaty Case Law IBFD.

<sup>69</sup> K. DZIURDZ and F, POTGENS, Ibid. p. 408.

<sup>70</sup> OECD-Commentary on Art. 15, paragraph 1.

of applying Art. 15 is an evidence that the Court considered Noentiendo as the real employer; it is not possible, in other words, both to deem Art. 15 as applicable and to consider Sonica as the employer. The former interpretation excludes the latter and vice versa.

82. Consequently, for the reasons above, we suggest the Court to conclude that the taxpayer had to be taxed only in Gameland under Art. 15(1) in 2012.

## **7. Art. 7 of the DTC.**

83. In case the Court followed a formal approach, the applicant shall be considered to be a self-employed. Under Art. 7, his profits may be taxed in Gameland only if they are attributable to a “permanent establishment” situated therein. In fact, the definitions of “enterprise” and “business”, contained in Art. 3 of the Convention, in addition to the deletion of Art. 14 which has been incorporated by Art. 7 on business profits, leave no doubt on the applicability of the PE concept to the performances of professional services of an individual character. Paragraphs 4 and 10.2 of the Commentary to Art. 3 confirm this statement. Therefore, we will demonstrate the existence of a PE in Gameland.

### **7.1. The concept of PE.**

84. There are several categories of PEs. Our attention will be focused on the traditional “physical PE”<sup>71</sup>. We will take into consideration the relatively new “services PE”<sup>72</sup> concept only in order to highlight its systematic importance in the broadening of the PE definition.

85. It is important to point out that our analysis will be conducted in the light of the theory according to which the three main criteria to materialize a PE are of unequal importance: while traditionally the disposal condition, the permanence condition and the geographic connection condition must be met simultaneously, it has been argued that if one of the criteria is passed with obvious certainty, then both of the remaining criteria may be weaker and therefore become less crucial<sup>73</sup>.

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<sup>71</sup> Art. 5.1 OECD Model.

<sup>72</sup> Art. 5.3 UN Model and OECD-Commentary (from 2008) on art. 5, paragraphs 42.11 – 42.48.

<sup>73</sup> J. SCHAFFNER, *The Territorial Link as a Condition to Create a Permanent Establishment*, in INTERTAX volume 41, 2013, p. 640.

86. Art. 5(1) defines the PE as a “*fixed place of business, through which the business of an enterprise is wholly or partly carried on*”. From this definition it derives that several conditions have to be met to create a physical PE: (i) a business has to exist; (ii) an activity has to be exercised at the place which is supposed to be a PE; (iii) the place of establishment has to be at the disposal of the enterprise exercising its activity therein; (iv) the place of establishment has to be “fixed”. In addition, under art. 5(4) the activity must not have an ancillary or preparatory nature.

87. The words “through which” mean that the enterprise must have the place “at its disposal”<sup>74</sup>. Having something at the disposal of the enterprise is nothing more than actual use. The mere presence of an enterprise at the location does not amount to a power of disposition. What is needed is a “material presence”, which means “material use”. This requirement is met when the use of the place is so extensive that it goes beyond the mere presence, regardless of the form of authorization allowing the use itself. Furthermore, there is no need for an implicit authorization to use the location in order for the use itself to be sufficient to conclude that the location is at the enterprise’s disposal. It has been affirmed that the “right to use test” is met if the taxpayer’s use of the place of business cannot be prevented without his consent. This intermediate view, although consistent with a literal interpretation of the term disposal, does not seem to apply to many practical situations including, *inter alia*, the illegal use of a place: in circumstances of illegal use, the authorities can always prevent the taxpayer’s use of the place without his consent, just because that use is simply contrary to law<sup>75</sup>.

88. In the traditional analysis, a physical PE requires a fixed location on the ground. This requirement for a geographic location has weakened over the time: in fact, it is well known that some activities may necessitate continuous relocation and performance within a more or less spatially delimited area. For this reason, the “coherent whole commercially and geographically” concept, introduced by the OECD in the Commentary in 2003 for the “physical PE”, creates a nexus between different locations to bundle them into a PE to better fit those activities which are for their nature “mobile”<sup>76</sup>.

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<sup>74</sup> OECD-Commentary on Art. 5, paragraph 4.

<sup>75</sup> A. CARIDI, *Proposed Changes to the OECD Commentary on Article 5: Part I – The Physical PE Notion*, in *European Taxation*, IBFD, 2003, p. 9.

<sup>76</sup> OECD-Commentary on Art. 5, paragraph 5.1.

89. More specifically, it appears that the commercial coherence concept prevails over the geographic connection in the sense that when the nature of a business requires the use of different locations, it just needs to be confirmed that (i) the locations are neighbouring (although it is not clear how close they should be) and that (ii) the same business is exercised in those locations. The geographic connection to the ground is, in these cases, replaced by a “spatial delimitation”.
90. Combining the examples proposed in paragraphs 3,4 and 5.2 of the Commentary to Art. 5, it can be stated that coherence is determined on the basis of three different tests: (i) timing test: no excessive time lag between the locations, (ii) objective test: the activities should fall within the scope of a single contract, (iii) subjective test: the services should be provided to a single client<sup>77</sup>.
91. In addition, the example provided in paragraph 5.4 of the Commentary deserves our attention: where a consultant works in different offices in the same location for the same client, the coherence test is met, but this test is failed if the consultant moves between branches in different locations.
92. This example was criticised by several commentators<sup>78</sup>. In particular, it is asked if it is correct to emphasize more the characteristics of the business rather than the purely geographical element. In Schaffner’s opinion the example at hand would fall precisely under the spatial delimitation theory, being the three tests above fulfilled.
93. Furthermore, country practices may also explicitly depart from the OECD guidelines in this respect. Czech Republic, for instance, made an observation to this Commentary’s paragraph specifying that it does not agree with the interpretation of the example at hand: it considers that it is irrelevant that the activities are carried out at different locations. As the places of business form part of a single project, they are commercially coherent and should constitute a PE if the

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<sup>77</sup> A. CARIDI, *Ibid*, p. 15.

<sup>78</sup> A. CARIDI, *ibid*, p. 16; B. J. ARNOLD, *Threshold Requirements for Taxing Business Profits under Tax Treaties*, in BULLETTIN – TAX TREATY MONITOR, IBFD, 2003, p. 485; J. LÜDICKE, *Recent Commentary Changes concerning the Definition of Permanent Establishment*, in BULLETTIN – TAX TREATY MONITOR, IBFD, 2004, p. 191; J. SCHAFFNER, *ibid*, p. 644.

other tests are met.<sup>79</sup>

94. According to the Commentary, the place of business will satisfy the time requirement if it has a “*certain degree of permanency i.e. if it is not of a purely temporary nature*”<sup>80</sup>. Neither the Model Convention nor the Commentary provide any firm rules for interpreting the time threshold. The Commentary simply refers to the six-months general practice of the OECD member States, but it also provides some deviations from this rule. For example, this concerns cases of premature terminations due to unforeseeable events (e.g. death of the taxpayer)<sup>81</sup>, or cases in which the business is conducted exclusively in one country<sup>82</sup>. With reference to the latter exception the doctrine<sup>83</sup> mentioned the situation of an entrepreneur who operated a catering service in another country for 4 months. With reference to this situation, described in the 2011 draft version of the paragraph 6.2 of the OECD-Commentary, the Working Party assumed the existence of a PE.
95. Furthermore it is stated that the period of time needed to assess the existence of the PE may be very short depending on the nature of the business<sup>84</sup>. It derives that the six-months period is not always the right choice and it can be adjusted on the basis of the peculiarities of the business itself. A demonstration of this is the fact that some States include provisions dealing with the period of time which is required for the performance of services to fulfil the permanence test: for instance Australian Income Tax Treaties with India or with Taipei provide respectively a 90-day and a 120-day time period<sup>85</sup>.
96. Differently, the Belgian Commentary states that the first intention of the taxpayer is a decisive criterion when assessing whether the permanency requirement is fulfilled: the initial intention to have a presence for a lasting period in the source State is sufficient for the permanency

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<sup>79</sup> CZ: Notification 494/1 173/2003, issued by the Ministry of Finance of the Czech Republic and Financial Bulletin 8/2003.

<sup>80</sup> OECD-Commentary on Art. 5, paragraph 6.

<sup>81</sup> OECD-Commentary on Art. 5, paragraph 6.3.

<sup>82</sup> OECD-Commentary on Art. 5, paragraph 6.

<sup>83</sup> X. DITZ & C. QUILITZSCH, *The Definition of Permanent Establishment: Current OECD and German Case Law Developments*, INTERTAX, Volume 40, 2012, p. 561.

<sup>84</sup> CA: TC, 8 Aug. 1990, *Fowler v. MNR*, 90 DTC 1834 – from J.S.WILKIE, *Substance in International Taxation*, IBFD 2014.

<sup>85</sup> T. TORYANIK, *The Concept of Substance in International Taxation – Australia*, in *International Transfer Pricing Journal*, IBFD, 2014, p. 440.

requirement to be fulfilled, even if the stay is eventually shortened because of (exceptional) circumstances<sup>86</sup>. Indeed, some authors remarked the importance of the “intended duration” in order to verify the fulfilment of the permanency requirement. In particular, it has been affirmed that: *“the intended duration of the place of business is the central factor of the permanency requirement, whilst the actual duration of physical presence plays a minor role<sup>87</sup>”*.

97. It is important to remark that the commercial and geographic coherence theory, described above with regard to the geographic criterion, has also an important influence on the permanence test. In particular, it does not matter if the single place of business does not fulfil the permanency requisite: if the activities are part of the same project, even if executed at different locations, the period of time shall be aggregated into one single PE<sup>88</sup>.
98. A final consideration on the concept of PE concerns the systematic importance of the introduction of the “services PE” notion. Unlike the traditional PE, the services PE only requires the presence of an enterprise in a given jurisdiction to perform the relevant services, in addition to a certain degree of permanence.
99. The introduction of this particular kind of PE into the 2008 Commentary shall be seen as an answer to the inappropriateness of the traditional “fixed place of business concept” to understand the new 21<sup>st</sup> century economic phenomena, based primarily on services and electronic commerce<sup>89</sup>. Indeed, the adoption of the “services PE” provision leads to the weakening of the geographic criterion which is outweighed by the permanence test in order to cover those phenomena which would not otherwise follow under the traditional PE definition.
100. This reasoning is confirmed by the general consensus of the doctrine about the fact that this provision was intended to be a clarification of the OECD Model definition of PE rather than a deviation<sup>90</sup>.

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<sup>86</sup> Commentaries Belgian income tax treaties, no. 5/104.

<sup>87</sup> S. SHALAV, *The Revised Permanent Establishment Rules*, in INTERTAX, Volume 31, 2003, p.137.

<sup>88</sup> Brian J. Arnold, Threshold Requirements for Taxing Business Profits under Tax Treaties, IBFD 2003.

<sup>89</sup> B. J. ARNOLD, *ibid*, p. 479; J. SCHAFFNER, *ibid*, p. 643.

<sup>90</sup> E. REIMER, N. URBAN & S. SCHMID, *Permanent Establishments. A Domestic Taxation, Bilateral Tax Treaty and OECD Perspective*, Kluwer Law, 2012, p. 113.



101. Although this provision is confined to the Commentary and did not turn into an article of the Convention, it still plays an important role in recognizing the necessity to interpret the conditions which are requested for a PE to exist in a broad and flexible manner, and in relation to the specific business which is performed.

## **7.2. Existence of a PE in the case at hand.**

102. Referring the notions above to the case at hand, it is possible to state that the applicant fulfils all the criteria which are needed for a “physical PE” to exist.

103. The applicant was a self-employed who performed services consisting in providing guidance to the programmers and other members of the staff of Noentiendo. The activity was exercised in the offices of Noentiendo, which altogether constituted the unique place of business which is deemed to be a PE.

104. The taxpayer had disposal over the different offices’ rooms. As stated above, it does not matter that the possibility to use the rooms is subordinated to the availability of the same. The actual use must be deemed to be sufficient.

105. The place of business shall be considered to be fixed. It is of no relevance that the rooms are located in different branches: as explained above, under the spatial delimitation theory, different branches can be considered to be a coherent whole both commercially and geographically speaking, contrary to what is explained in paragraph 5.4 of the Commentary. Even if the Court rejected the argument of the geographical coherence, it shall be remembered that the commercial coherence shall prevail over the geographic criterion. The commercial coherence must be deemed to be existent because the three tests listed above (timing, objective and subjective) were fulfilled. In particular, all the services which are provided by the taxpayer were directed to the same client (Noentiendo), for the development of the same videogame.

106. The permanence test was fulfilled as well. Even if the applicant never spent more than one week in every single office, the calculation must be made taking into consideration the time spent in all the offices together<sup>91</sup>. In addition, the applicant’s activity was characterized by high

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<sup>91</sup> See annex.

mobility. Given the peculiarity of this business, it shall be reached the conclusion that the six-months rule of thumb is not appropriate for the case at hand, which falls under one of the deviations provided by the Commentary as seen above. In fact, firstly, it can be said that the contractual relationship between the applicant and the client has ended due to unforeseeable events, such as the applicant's disease. Secondly, the applicant exercised his activity only in Gameland because of the fact that the latter state was the only one in which the activity could be carried on. Both these conditions make the exceptions provided in the Commentary available for the taxpayer, so that the permanency test must be deemed as fulfilled even in a shorter period of time. As a further argument, one should not overlook the fact that the first intention of the parties when signing the contract was to establish a working relationship which was to last at least for 1 year. If the Court considered to accord relevance to the intended duration of the business, it should not ignore this argument.

*107.* As a final remark, we suggest the Court to keep into consideration that, according to the theory exposed above, the permanence condition shall be considered preeminent: since permanency is seen as the best demonstration of the existence of an economic nexus to the jurisdiction of activity, it is advisable to tolerate more flexibility for the other tests once the permanence condition is fulfilled.

*108.* In conclusion, the applicant satisfied all the criteria needed for the existence of a “physical PE”. The different Noentiendo’s offices shall be deemed to constitute a unique PE through which the taxpayer performed his services.

### **7.3. Effects of the application of Art. 7.**

*109.* If the Court shared the conclusion of considering a PE to be existent in Gameland, and of recognizing all the taxpayer’s profits to be attributable to that PE, then all the income shall be taxed in Gameland under Art. 7(1).

### **8. Art. 17 of the DTC.**

*110.* If the Court rejected the argument based on Art. 7, the applicant shall be taxed in Gameland under Art. 17.

111. This article assigns the taxing right, in relation to income derived by an Entertainer or a Sports person, to the State of performance. By including Art 17 in a tax treaty, the source State can secure more taxing rights than applying Art(s). 5 and 7, which both require a longer presence in the performance's State,<sup>92</sup> necessary to fulfill a 6-month time threshold<sup>93</sup>.
112. Before starting the analysis of Art. 17, it should be mentioned that in 2010 there was a first update to this provision and its Commentary, followed by another update in 2014. The title of the article has been changed from "*Artistes and Sportsmen*" to "*Entertainers and Sports persons*" and the Commentary has doubled its size. The first question is whether this updated version of the Commentary has an impact on the treaty between Gameland and Rainbowland or whether it is just applicable to subsequent treaties.
113. As aforementioned<sup>94</sup>, the weight to be given to later OECD Commentaries depends on the extent of the changes: the less substantial, the greater the weight<sup>95</sup>. When changes clarify the text's meaning rather than introduce new principles, they may be used even in relation to an earlier tax treaty.
114. We will demonstrate that the new Commentary can be consulted, since the update was just a clarification. This results from a brief analysis of the new paragraphs 8.1, 9.1- 9.5, 10.1-10.5<sup>96</sup>.
115. As regards the changes of paragraphs 8.1 and 9.4- 9.5, they clarify whether or not Art. 17 applies to payments as prizes and awards for an event, consideration for broadcasting, merchandising and use of image rights<sup>97</sup>. Paragraph 9.1 clarifies cases where it is unclear if either the subjective element (sports amateur or persons who get fees for single appearance in television or movie) or the objective one (advertising or interviews, preparation, rehearsal and training) are fulfilled. Paragraphs 9.2-9.3 introduce general principles and examples to

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<sup>92</sup> K. TETLAK. *Tax Treatment of Team Performances under Art.17 of the OECD Model Convention* in world tax journal 2010 p.263

<sup>93</sup> A. LEDESMA *The Artistes and Sportsmen's Article (Article 17 of the OECD Model): Has the Time Come To Stop Counting Stars in the Sky?* in European taxation February-March 2012 p.116

<sup>94</sup> See §68 sequent of this memorandum.

<sup>95</sup> M. NIEMINEN *Dual Role of the OECD Commentaries – Part 1* in INTERTAX, Volume 43, Issue 11 2015 Kluwer Law International BV, The Netherlands p.636.

<sup>96</sup> Since for the case only paragraph 1 of art. 17 is applied, the analysis is just on the update of this paragraph.

<sup>97</sup> OECD Issues related to Article 17 of the OECD Model Tax Convention adopted by the OECD Committee on Fiscal Affairs on 26 June 2014 p.8-9.

determine which part of the income from performance is taxable in a State, when the activity took place in more than one State. Paragraphs 10.1-10.5 propose an alternative version of paragraph 1 which exempts non-residents who earn low amounts of income from activities carried out in the State of performance.

116. After this analysis it appears that the update is a mere clarification of the 2003 version, therefore it can be used by the applicant, following the same dynamic approach of his previous argumentations.

117. After solving the issue of interpretation, it is necessary to prove that the applicant's income could be taxed as income from entertainment, fulfilling the subjective conditions requested by Art.17.

118. The word "Entertainer" includes anyone who entertains (e.g. dancer, singer, comedian, actor). The Commentary<sup>98</sup> includes other examples specifying that they should not be considered as exhaustive since "*in between there is a grey area where it is necessary to review the overall balance of the activities of the person concerned*". It must be said that this is one of the cases which stand in the "grey area", given the difficulty to determine whether the applicant's income derives by entertainment or not.

119. The taxpayer ended his career in 2005, seven years before signing the contract with Sonica. For this reasons it is challenging to consider him as an Entertainer or even as a Sportsman<sup>99</sup>. However, he was also hired to support the game's marketing through his celebrity, derived mostly from his social life rather than his artistic or athletic performances. Thus, it is self-evident that the taxpayer cannot be considered a Sportsman or a traditional Entertainer according to the definitions given by the Commentary.

120. However, after the Discussion Draft of 2010 some renowned scholars<sup>100</sup> argued that the new notion of Entertainer is too narrow and not in line with the modern understanding of this

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<sup>98</sup> OECD-Commentary on Art. 17, paragraph 1.

<sup>99</sup> A.B. MORENO *Contract Splitting and Article 17 of the OECD Model: Is Source Taxation of Artistes and Sportsmen a New Dummesteuer?* in Bulletin for International Taxation, 2014 (Volume 68), No. 3 p.1.

<sup>100</sup> D. MOLENAR, M. TENORE and R. VANN *Red Card Article 17?* Bulletin For International Taxation, March 2012 p.127.

concept. Indeed, it is quite common that payments received by former athletes relate more to their celebrity status than to any performance. This view was shared also in one of the public comment on the draft,<sup>101</sup> and was supported by the example of a UK's celebrity called Jade Goody, who appeared on a number of television shows but could not be classed as a performer, having no particular skills rather than fame. This resulted in a non-taxation in the State of the appearances.

121. The OECD Committee on Fiscal Affairs did not provide a solution for these complaints<sup>102</sup>. The only reasonable chance to avoid non taxation in these cases is to interpret in a broader way the term Entertainer, including celebrities whose fame is related to a past sport career and whose income derives mostly from other activities, closely related to their previous sport performances.
122. This interpretation is endorsed by the Commentary<sup>103</sup>, which states that the income is from entertainment when there is a close relation between the income itself and the previous sport performances. *“Such a close connection will generally be found to exist where it cannot reasonably be considered that the income would have been derived in the absence of the performance of these activities”*.
123. Although the taxpayer was not hired to race or entertain in a strict sense, the contract's consideration for his income was closely related to his previous experience as a racer and also to his celebrity. In fact, his role was to provide help in order to develop the game, using the knowledge acquired in his past athlete's career, and to endorse it for the increase of the sales.
124. Thus, the contract of the applicant can be considered as an atypical endorsement contract which requests the endorser's image to be associated with the product to sell. This qualification can be implied from the termination of the contractual relationship: the applicant was fired not due to breaches of the contract, but because his image was compromised by scandals in the magazines and this would have resulted in a reputational damage for the company. It is possible to identify a similarity between this situation and the moral termination clauses which are

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<sup>101</sup> Public Comments on the Discussion Draft on the application of Art. 17 (Artistes & Sportsmen) of the OECD MC by Managers Music Forum (MMF) p3 point 9.

<sup>102</sup> In supra 101.

<sup>103</sup> OECD-Commentary on Art. 17, paragraph 9.

normally preeminent features of endorsement agreements<sup>104</sup>. Reference can be made to real athletes who were distanced by their sponsors due to the bad publicity related to their conduct (Tiger Woods' marital problems<sup>105</sup>, Lance Armstrong's use of illegal substances, Oscar Pistorius charges of premeditated murder)<sup>106</sup>.

125. It derives that the income perceived by the applicant should be considered as closely related to his previous sport career and his celebrity, therefore covered by Art.17. Under this allocation rule, the applicant's income shall be taxed in Gameland since it is the State of performance.

## 9. Conclusions.

126. In conclusion, we have demonstrated that in 2012 the taxpayer was a resident of Gameland. If the Court shared this assertion, the applicant shall not be taxed in Rainbowland since there was no income sourced there. On the other hand, if the Court considered the taxpayer as a resident of Rainbowland, all of his income (sourced in Gameland) shall not be taxed in the former State, because the allocation rules contained in the DTC attribute the right to tax to Gameland.

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<sup>104</sup> C.R. CHASE, *A Moral Dilemma: Morals Clauses in Endorsement Contracts* Sports Litigation Alert, Volume 6, Issue 6 (April 10, 2009) p.87.

<sup>105</sup> S. BOYD, BARRISTER, SELBORNE CHAMBERS SPORT *Image Rights Contracts: Morality Clauses In Sports And The Law* Journal Opinion And Practice Volume 18 Issue 1 p.16.

<sup>106</sup> M. BOTES *Sponsoring of Sports Stars and Other Celebrities* in international VAT monitor March April 2013 p.23

## VII. Annex

### TOTAL AMOUNT OF DAYS SPENT BY THE TAXAYER IN EACH COUNTRY

#### 1. Total amount of days spent in Rainbowland:

- Every weekend (Saturday and Sunday) from the 7<sup>th</sup> of January 2012 to the 17<sup>th</sup> of June = 58 days;
- From the 21<sup>st</sup> of June 2012 to the 31<sup>st</sup> of October 2012 (included) = 123 days.

Total amount of days spent in Rainbowland = **181**.

#### 2. Total amount of days spent in Gameland:

- From the 1<sup>st</sup> of January 2012 to the 20<sup>th</sup> (included), not taking into consideration every weekend from the 7<sup>th</sup>/8<sup>th</sup> of January 2012 (= 124 days);
- From the 1<sup>st</sup> of November 2012 to the 31<sup>st</sup> of December 2012 (period of rehab in the clinic) = 61 days.

Total amount of days spent in Gameland = **185**.

#### 3. Total amount of days with reference to the PE:

- 166 days (including the weekends in Rainbowland). This calculation is made taking into consideration the provisions contained in paragraphs 6.1, 11 and 19 of the OECD-Commentary to Art. 5.
- 120 days (not including the weekends in Rainbowland).

## VII. Table of Abbreviations

Art(s)..... Article(s);

DTC..... Double tax convention between Rainbowland and Gameland;

OECD ..... Organization for Economic Co-Operation and development;

OECD-MC ..... OECD Model Convention;

CVI..... Centre of Vital Interest;

PE ..... Permanent Establishment;

VCLT..... Vienna Convention on the Law of Treaties.



International & European Tax Moot Court  
Competition

2015/2016

**MEMORANDUM FOR THE DEFENDANT**

Registration number: M/001

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### **III. Statement of Facts**

The taxpayer is Dario von Klempner, born in Rainbowland, also known as Super Dario for his past career as a kart racer, during which he won the prestigious International Moot Kart Competition. Unable to repeat his past victory, he ended his kart racing career in 2005. In the same year he married Countess Peach and later, together with her and their two kids, he settled in a gorgeous house in the capital of Rainbowland. Super Dario's private and social lifestyle featured on the cover of many magazines, he was worldwide considered as a celebrity.

Since the end of his career, he was contacted by Noentiendo, a company established in Gameland, whose object is the development of computer games. The CEO of the company wanted to hire him, to improve the car racing games and attract the attention of the media onto his company and his products, through Super Dario's endorsement. Super Dario accepted and went to Gameland, signing a contract on 2 January 2012. To his surprise, he was not given an employment contract but a freelance contract in which the counterparty was not Noentiendo but Sonica, a company resident in Playland, not associated with Noentiendo and whose social objective was also the development and sale of computer games. Between Sonica and Noentiendo there was an agreement: the former would provide services and external consultants on a regular basis, charging their gross cost plus a 5% surplus fee. This would have enabled Noentiendo to be more flexible in the workforce's organization while having major tax and social security savings, as the tax burden in Playland was considerably lower.

The freelance agreement between Super Dario and Sonica had a duration of 1 year, renewable for equal periods, during which he would have provided his services as consultant at the premises of the ten different offices of Noentiendo in Gameland, under its COO instructions. Super Dario normally rotated between the offices on a weekly basis, in accordance with the yearly plan drafted by the COO, staying usually in the same room or moving from one room to another, depending on their availability. This was not a problem, since he could provide his service, through a laptop with a strong internet connection, from the different apartments and hotels booked and paid by Noentiendo. He was also entitled to e-work 1 week per month, which he did from a touristic location in Gameland. During the weekends he stayed in Rainbowland, where he went to the



stadium to watch his football club, attended the Sunday Mass and also a lot of parties and social events.

From the end of March 2012 social magazines started to spread bad rumors about Super Dario, fearing negative publicity for the company the contract was terminated with immediate effect on 15 June 2012. After coming back home in Rainbowland on 20 June 2012, Super Dario returned to drinking and mostly lived off paid appearances at nightclubs. On 31 October 2012, he decided to check into a rehab clinic in Gameland, based on a strict policy: patients enter voluntarily but can only leave when they are considered clean. He was released from there on 31 December 2012.

The tax authority of Rainbowland, through an assessment, contests the fact that Super Dario did not file his 2012 tax return there. Super Dário appealed against it before Rainbowland's court. The Tax Authority sustains its claim considering the applicant as a resident of Rainbowland and all of his income as taxable in it, even if sourced in Playland, due to the lack of a double tax treaty between the two States. Even if the income would be considered as sourced in Gameland, it would nonetheless fall under an allocation rule that allows exclusive taxation by the residence State.

## IV. Issues

1. Residence issues:
  - 1.1 Double residence according to internal tax law;
  - 1.2 Residence in Rainbowland according to the DTC;
  - 1.3 Permanent home
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    - 1.3.2 the concept of Availability;
    - 1.3.3 the concept of Permanence;
  - 1.4 Centre of Vital Interest;
  - 1.5 Habitual abode;
  - 1.6 Nationality;
  - 1.7 Conclusions: Rainbowland as the residence State.
  
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  - 2.1 Attribution of the taxing power to Rainbowland.
  
3. Gameland as the source State;
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4. On the applicability of Art. 7 of the DTC:
  - 4.1 The concept of PE under Art. 5 of the DTC;
    - 4.1.1 The fixed nature of the place of business;
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5. Non applicability of Art. 15 of the DTC:
  - 5.1 Non applicability of subsequent Commentaries;
  - 5.2 The 2003 version of the Commentary only refers to abusive hiring out of labour practices;
  - 5.3 According to the 2010 version of the Commentary, a formal approach must be followed by Rainbowland;

- 5.4 Conclusions: non applicability of Art. 15 of the DTC.
  
- 6. On the applicability of Art. 12 of the DTC:
  - 6.1 The term Royalties;
  - 6.2 The term Beneficial Owner: a substantial approach;
  - 6.3 The fulfilment of these two requirements in the case at hand;
  - 6.4 Non applicability of Art. 12(3) of the DTC;
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- 7. Non applicability of Art. 17 of the DTC.
  
- 8. Conclusions.

## **V. Arguments**

### **1. General Remarks**

1. This document aims at providing that the claims made by the taxpayer are unfounded; firstly, in respect of the attribution to the applicant of the tax residence in Gameland, secondly with regard to the correct application of the distributive rules of the DTC which is in force between Rainbowland and Gameland.
2. The first considerations will then concern the application of the internal tax rules on residence of Rainbowland and Gameland. Once we have verified that a double residence shall be envisaged, it will be necessary to apply the DTC between Rainbowland and Gameland whose provisions, contained in Art. 4(2), aim to resolve this type of conflicts.
3. In this respect we aim to demonstrate that the correct interpretation of the tie-breaker rules in the case at issue requires to consider the applicant resident for tax purposes solely in Rainbowland.

### **2. Residence according to Gameland and Rainbowland domestic law.**

4. In 2012 the taxpayer was a resident in Rainbowland and Gameland under their domestic law, since in both cases he satisfied the criterion of the length of stay (more than 110 days)<sup>107</sup>.
5. Therefore, since the three criteria provided by the domestic law of the two States are of an alternative nature, the fulfilment of the “length of stay criterion” is enough to establish the residence in both of the States according to their domestic law.

### **3. Residence in Rainbowland according to the DTC.**

6. In order to solve the issue of dual residence, Art. 4(2) of the DTC shall apply. It contains the tie-breaker rules which tip the balance of residence towards Rainbowland.

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<sup>107</sup> See annex.

7. First of all, the residence State is the State where the individual has his permanent home. Regarding this concept, Art. 4(2)(a) of the DTC indicates three elements: home, availability, permanence<sup>108</sup>.

### 3.1. Permanent home: the concept of home.

8. As regards the term “home”, the scholars<sup>109</sup> highlighted that a subjective interpretation has to be adopted. Its purpose is to distinguish the objective component that underlies this notion (the house<sup>110</sup>) from the subjective component, which consists in the personal link between the house and the individual considered. In fact, such personal link causes the qualitative change of a simple “house” into a “home”, which is to be intended as “the seat of domestic life and interests”<sup>111</sup>.

9. From a juridical point of view, this interpretation entails a link between the personal interests of an individual and his house, and thus with the territory of the State where those interests are located. Hence there is some overlap between the permanent home notion and the personal relations which are at the basis of the centre of vital interests<sup>112</sup> concept.

10. This interference is not harmful; on the contrary, it complies with the overall ratio of Art. 4(2), which aims at determining the State where the individual has his strongest ties. A systematic interpretation of the hierarchy of the dual residence tests shows that Art. 4(2) puts at the highest level those tests which require detailed factual investigations, including especially subjective elements, in order to locate the residence in the State where personal ties are more relevant for the individual considered. Only when the first subjective tests progressively fail, Art. 4(2) refers to formal criteria such as the habitual abode and the nationality<sup>113</sup>.

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<sup>108</sup> E. STUART, *Art. 4(2) of the OECD Model Convention: Practice and Case Law*, in G. MAISTO, *Residence of individuals under tax treaties and EC Law*, IBFD, 2010, p. 184.

<sup>109</sup> K. VOGEL, *Klaus Vogel On Double Taxation Conventions*, Kluwer, 1997; See also, J. AVERY JONES ET AL., *Dual residence of individuals: the meaning of the expressions in the OECD model convention*, in *British Tax review*, 1981, p. 15.

<sup>110</sup> OECD-Commentary on Art. 4, paragraph 13.

<sup>111</sup> J. AVERY JONES ET AL., *Ibid.*, p. 24.

<sup>112</sup> J. AVERY JONES ET AL., *Ibid.*, p. 30.

<sup>113</sup> Consistently with this statement, AVERY JONES J. ET AL., *Ibid.*, p. 17.

11. This statement is confirmed reading the first report of the OEEC (which, in 1961, became the OECD) on fiscal domicile. The report proposed several factors to be taken into account in order to identify the State of fiscal domicile; these factors were distributed in a list ranging from the strongest personal and subjective ties of an individual (residence of wife and children, relatives and so on) to the weakest and most formal ties (such as citizenship, capital investments and earnings)<sup>114</sup>. By referring to Art. 32 of the VCLT we infer that indications deriving from the report of the OEEC must be taken into consideration as supplementary meanings when interpreting the term “permanent home”.
12. The application of this reasoning to the case at issue shows the presence of a home in Rainbowland, since both the requirements (objective and subjective) are detected: the applicant settled in a gorgeous apartment in Rainbowcity (the capital of Rainbowland) in 2005 with the intention of using it as his home after he got married with a countess of Rainbowlandic nationality who gave him two kids. Moreover, his wife and children always resided in this house, to which the taxpayer himself frequently returned also when he was working in Gameland. Hence, it goes without saying that also in 2012 the apartment located in Rainbowland was the unique permanent home, namely the “the seat of domestic life and interests”, of the taxpayer.
13. We shall draw opposite conclusions about the apartments, the hotels’ and clinic’s room rented in Gameland. In fact, the rental of those apartments and rooms found its cause in the taxpayer’s need to better attend to his economic interests in Gameland. If we consider a home as the seat of domestic life, economic interests cannot have whatsoever importance. Moreover, it should be noted that from January to June of 2012 the apartments and rooms were rented and paid in Gameland not by the applicant but by the Noentiendo’s offices where he provided his services. On the other hand, concerning the room where the taxpayer stayed when he was into rehab, it certainly cannot be regarded as his “seat of domestic life and interests”. As a result, only the house in Rainbowland shall be deemed as a “home”.

### **3.2. Permanent home: the concept of availability.**

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<sup>114</sup> J. SASSEVILLE, *Ibid.*, p. 157.

14. The concept of availability is opposed to actual presence. Therefore the number of days when the individual stayed in several parts of Gameland has little importance<sup>115</sup>. In fact availability takes into consideration not only the concrete disposal of the house, but also what the owner is potentially entitled to do. Thus, an actual power of disposition which allows the individual to set the conditions of occupation of the house itself<sup>116</sup> on the basis of a continuous availability<sup>117</sup> is the only necessary requirement.
15. When it refers to the element of availability, the OECD Commentary considers within its examples only the hypothesis of ownership and rent<sup>118</sup>. In fact, only the ownership or the rental of a place confer the power of disposition and of setting the conditions of occupation of the house itself on the basis of a continuous availability. This conclusion is endorsed by the German jurisprudence, which requires an actual power of disposition as well<sup>119</sup>. German Courts not only demand the factual use by the individual, but also a right to use<sup>120</sup>.
16. Provided that, it is not doubtful that the applicant is the owner of the apartment located in Rainbowland and neither the owner nor the lessee of the apartments and rooms located in Gameland. Indeed, the latter places were rented by the several Noentiendo's offices which the taxpayer provided his services to in 2012 and, concerning the clinic room, the applicant cannot be deemed to be its tenant in a legal sense.
17. As a result, in the taxable year involved the requirement of the availability was met only in Rainbowland and not in Gameland.

### 3.3. Permanent home: the concept of permanence.

18. Regarding the term "permanent", the Commentary states that it excludes all the hypothesis of short stay and that this aspect shall result from circumstances pertaining to how the dwelling

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<sup>115</sup> K. VOGEL, *Ibid.*, p. 248; AVERY JONES J., *Ibid.*, p. 116.

<sup>116</sup> K. VOGEL, *Ibid.*, p. 248.

<sup>117</sup> OECD-Commentary on Art. 4, paragraph 13.

<sup>118</sup> *Ibid.*

<sup>119</sup> *Reichsfinanzhof*, RStB1. 1934, 341; Lehner in Vogel/Lehner, *Doppelbesteuerungsabkommen*, Munchen, 2008, Art. 4 marg. note 182.

<sup>120</sup> *Bundesfinanzhof*, 05.06.2007, BStB1. II, 2007, 812: it refers to "Rechtposition"; see also *Bundesfinanzhof*, 16.12.1998, BStB1 II, 1999, 207.

itself is arranged<sup>121</sup>. In this respect a literal interpretation of the term “permanent” reflects a concept of indefinite duration<sup>122</sup>. It follows that it is necessary to consider also elements that do not pertain to the tax period at issue, since a permanent home must be distinctly longer than a residence<sup>123</sup>.

19. This interpretation however, pertains only to the linkage between the term “permanent” and “available”<sup>124</sup> while, first of all, we shall consider the connection between “permanent” and “home”. If the DTC was intended to refer permanence only to the availability, it would have probably used an expression such as, for instance, “home permanently available”. As a result, if “home” is the seat of domestic life and it has to be “permanent”, we must verify whether the personal interests that can be found in the relevant State are located there with a certain stability, namely, in the case of a family, if its presence is related to the fact that it actually settled there.

20. The apartment in Rainbowland meets this requirement. Firstly, being a villa and not just a small apartment or a hotel’s or a clinic’s room, it is adequate to Dario’s general wealth and this circumstance makes it not reasonable to consider it as a temporary habitation. Moreover he purchased it and moved in it just in the same period when he got married and afterwards his wife had two children. This further circumstance reveals the intention of setting there a durable dwelling, considering also that his family is clearly settled there for an indefinite period of time and it did not follow the applicant when he was working in Gameland.

21. On the other hand, the analysis of the apartments and rooms in Gameland leads to opposite conclusions. Firstly, from a subjective point of view, considering again the wealth of the taxpayer and his needs, the small apartments and rooms cannot be regarded as a permanent dwelling. Moreover, the availability of the apartments and rooms was limited. The applicant obtained their availability only in 2012, but it is not either possible to refer to “availability” in a legal sense. In addition, the taxpayer’s systematic return to his home in Rainbowland is a further argument that makes it impossible to consider the apartments and rooms located in Gameland as a permanent home. The Commentary itself<sup>125</sup> excludes that changing hotels on a continuous

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<sup>121</sup> OECD-Commentary on Art. 4, paragraph 12.

<sup>122</sup> K. VOGEL, *Ibid.*, p. 247; J. AVERY JONES ET AL., *Ibid.*, p. 48.

<sup>123</sup> See F. WASSERMEYER as quoted in K. VOGEL, *Ibid.*, p. 248.

<sup>124</sup> K. VOGEL, *Ibid.*, p. 247.

<sup>125</sup> OECD-Commentary on Art. 4, paragraph 18.



basis can constitute a permanent home. In fact, when it deals with the case in which an individual has not a permanent home in either Contracting State, the Commentary provides that this happens when the person goes from one hotel to another.

22. In conclusion, a permanent home available to the taxpayer shall be deemed to exist only in Rainbowland and the applicant shall be considered as resident there. Even if the Court reasoned that in 2012 the taxpayer had a permanent home in both States, under Art. 4(2) it would be necessary to identify the State which the applicant's personal and economic relations (centre of vital interests) are closer to. We will demonstrate that Rainbowland is that State.

### **3.4. Centre of vital interests<sup>126</sup>.**

23. The analysis of this concept requires to take into consideration the distribution of both personal and economic relations of the individual in order to establish the place of his strongest ties. In this respect the Commentary on Art. 4<sup>127</sup> clearly states that personal and economic relations have to be evaluated as a whole in determining where the centre of vital interests is located.

24. The first consequence is that the final assessment must be based on a “summarizing appraisal”<sup>128</sup> on which group of interests prevails over the others. In fact, the CVI test clearly requires a comparison of the facts in each State<sup>129</sup>. In second instance, it follows that the CVI is only one or eventually not capable of being defined<sup>130</sup>. However, before performing the final global assessment, it is necessary to establish the features of both personal and economic relations.

25. Economic relations pertain to activities linked to a specific place or to sources of income located in a certain territory, while personal ones have a very wide scope, since the Commentary itself makes a quite general list of examples of social relations like individual's occupations and his political, cultural and other activities.

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<sup>126</sup> Hereinafter CVI.

<sup>127</sup> OECD-Commentary on Art. 4, paragraph 15.

<sup>128</sup> K. VOGEL, *Ibid.*, p. 250.

<sup>129</sup> E. STUART, *Ibid.*, p. 187.

<sup>130</sup> K. VOGEL, *Ibid.*, p. 249.

26. Furthermore, as regards personal relations, the Commentary specifies that “personal acts” of the individual shall receive special attention<sup>131</sup>. This statement has to be interpreted in the sense that personal relations shall assume a heavier relative weight<sup>132</sup>. This interpretation is in line with the first draft concerning this tie-breaker rule: in 1957 the OEEC issued a report in which the CVI was equated to the expression “*place with which his (i.e. of the individual) personal ties are closest*”. The Commentary to that draft defined the CVI as the State to which individual’s personal relations are closer<sup>133</sup>. In the same year a new draft was issued and again the CVI was linked to the State where personal relations are closest<sup>134</sup>. Having said that, it should be noted that Art. 32 of the VCLT establishes that when interpreting a treaty, “*recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion*”. The two drafts and the Commentary quoted above can be considered as preparatory work of the OECD MC, because they have been the basis of the subsequent versions of the Convention<sup>135</sup>. Therefore, having regard to such a preparatory work as well, personal relations shall assume a heavier relative weight as to identify the State in which the CVI is located.
27. This interpretation is endorsed by several national Courts and administrations<sup>136</sup>. More precisely, concerning jurisprudence, the Austrian Administrative Supreme Court<sup>137</sup>, the Dutch Supreme Court<sup>138</sup>, the Luxembourg Court of Appeals<sup>139</sup> and the French administration<sup>140</sup> adopt an approach which gives preference to the personal relations of the individual<sup>141</sup>, while in Germany

<sup>131</sup> OECD-Commentary on Art. 4, paragraph 15.

<sup>132</sup> See J. AVERY JONES ET AL., *Ibid.*, p. 102.

<sup>133</sup> J. SASSEVILLE, *Ibid.*, p. 159.

<sup>134</sup> J. SASSEVILLE, *Ibid.*, p. 161.

<sup>135</sup> P. BAKER, *The expression “centre of vital interests” in Art. 4(2) of the OECD Model Convention*, in G. MAISTO, *Ibid.*, p. 178.

<sup>136</sup> See in this respect K. VOGEL, *Ibid.*, p. 251, and the analysis made by J. AVERY JONES ET AL., *Ibid.*, p. 106; For an example on a specific country (Austria): M. ZÜGER, E. LECHNER, H. TREER, in *Tax consequences for expatriates coming to Austria to work*, in Bulletin, December 2004, p. 566; M. ACHATZ, B. GRÖS, R. WEINIGER, *Taxation of Non-Resident Individuals in Austria*, in Bulletin, November 2004, p. 525; Some references to Austrian, Dutch and German approaches in P. BAKER, *The expression “centre of vital interests” in Art. 4(2) of the OECD Model Convention*, in G. MAISTO, *Ibid.*, p. 178.

<sup>137</sup> VwGH 25.2.1970, 1001/69 (to the former Austria-Germany DTC); 30.1.1991, 90/13/0165 (to the Austria-Poland DTC); 22.3.1991, 90/13/0073 (to the former Austria-Germany DTC); 26.7.2000, 95/14/0145 (to the Austria-Canada DTC); 19.3.2002, 98/14/026 (to the Austria-CSSR DTC); 26.2.2004, 99/15/0127 (to the Austria-Switzerland DTC); 9.11.2004, 99/15/0008 (to the former Austria-Germany DTC); 20.2.2008, 2005/15/0135 (to the Austria-Switzerland DTC).

<sup>138</sup> P. BAKER, *Ibid.*, p. 178.

<sup>139</sup> Luxembourg Court of Appeals 6 March 2001, [www. ibfd.com](http://www.ibfd.com).

<sup>140</sup> BOI 14 B-3-03, 22 May 2003; No. 13.

<sup>141</sup> See also E. STUART, *Ibid.*, p. 187.

the Bundesfinanzhof<sup>142</sup> has concluded that the answer depends upon which factors are given greater significance by the taxpayer; economic relations are only more important if they are more significant to the taxpayer than personal relations.

28. As regards the case at issue, no relevant personal relations can be detected in Gameland. Firstly because the applicant's family never left the apartment in Rainbowland and never reached him in Gameland. Moreover, he did not have social contacts whose importance was particularly relevant by comparison with those related to Rainbowland. On the other hand, his personal relations, both from a qualitative and a quantitative point of view, namely his family, are steadily located in Rainbowland.
29. In respect of economic interests, the most important part of his income was sourced in Playland, but other important economic relations are scattered in Rainbowland (where, after his firing in Gameland, he mostly lived off paid appearances at nightclubs) and in Gameland (where he provided his services to Noentiendo). Furthermore, he received monthly payments from Sonica's bank account (from a branch located in Playland), but they were made to his own bank account, located in Rainbowland (the importance of the place where the individual's bank account is located, in order to identify the CVI, was highlighted by many Courts<sup>143</sup>).
30. As a result, personal relations shall prevail within the context of the final assessment and these are mainly located in Rainbowland; on the contrary there is a certain degree of dispersion of economic relations, thus the centre of vital interests shall be deemed to exist in Rainbowland.
31. This conclusion is confirmed by the Commentary on Art. 4, which establishes that *"If a person who has a home in one State sets up a second in the other State while retaining the first, the fact that he retains the first in the environment where he has always lived, where he has worked, and where he has his family and possessions, can, together with other elements, go to demonstrate that he has retained his centre of vital interests in the first State"*<sup>144</sup>. In the case at issue, apart from the fact that the applicant did not set up a second home in Gameland, the *"other elements"*

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<sup>142</sup> Bundesfinanzhof, 23.07.1971, BStBl. II 1971, 758 (759).

<sup>143</sup> In this respect, see the decision of the Belgian Antwerp Court of Appeals, 17 October 2000, as quoted in T. and De Vos, P., *Handboek internationaal en Europees belastingrecht*, Antwerp: Intersentia, 2008, p. 124.

<sup>144</sup> OECD-Commentary on Art. 4, paragraph 15.

which the quoted statement refers to consist in the dispersion of the economic relations of the applicant.

32. However, even if the Judges deemed that the CVI cannot be determined or that the applicant had not a permanent home available to him in either State, it would be necessary to make use of the subsequent tie-breaker rule, concerning the habitual abode. We sustain that in 2012 the taxpayer had his habitual abode in Rainbowland.

### 3.5. Habitual abode.

33. With respect to the concept of habitual abode, the main interpretative question is whether the habitual abode test should be applied by merely taking into account the days of presence in each State over a certain period or whether having a habitual abode requires something more than just being there<sup>145</sup>.

34. The German and Canadian jurisprudence and the French administration seem to favour the second solution: having a habitual abode requires something more than just presence. Regarding the Canadian jurisprudence, the *Lingle v. The Queen* case (2009) is compelling in this respect<sup>146</sup>. The case concerned an individual who claimed that in two taxable years he was a resident of the United States, while Canadian Tax Administration affirmed that in the relevant period the taxpayer was a resident of Canada. By overruling two precedent decisions which stated that the habitual abode test simply requires a comparison between the days of presence in each State<sup>147</sup>, the Canadian Court concluded that “*the interpretation of habitual abode embodies more than simply a determination of in which State an individual stayed more frequently*”. The test is to be applied separately to each State, in order to ascertain whether or not the individual “*regularly, normally or customarily lived in that State*”<sup>148</sup>.

35. The same conclusion is shared by the German jurisprudence<sup>149</sup>, which observes that counting the days does not seem to be the right way to determine the habitual abode. In nearly all cases

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<sup>145</sup> J. SASSEVILLE, *Ibid.*, p. 165.

<sup>146</sup> *Lingle v. The Queen*, 9 september 2009, .

<sup>147</sup> *Allchin v. The Queen*, 8 April 2005; *Yoon v. The Queen* (22 July 2005).

<sup>148</sup> E. STUART, *Ibid.*, p. 190.

<sup>149</sup> *Finanzgericht Berlin*, 18.06.2002, IStR 2002, 845 (847).

this method would lead to the conclusion that the taxpayer has an habitual abode in only one of the Contracting States, while the Model Convention presupposes that the taxpayer can have an habitual abode in both Contracting States. Otherwise, the criterion of nationality would not be necessary<sup>150</sup>. Concerning the French Tax Administration, the Administrative Guideline 14 B-3-03 recognizes that an individual may be considered as having an usual place of residence (this is the concept that in French Tax Treaties usually replaces that of habitual abode, but it has the same characteristics<sup>151</sup>) in two States, even if the number of days spent in the first State is greater than the number of days spent in the other State. This interpretation is endorsed by the doctrine as well, which stresses the fact that under Art. 4(2) d) of the OECD MC it is possible for the individual to have a habitual abode in both States or in neither of them<sup>152</sup>. These circumstances are unlikely to arise on a comparison of day counts<sup>153</sup>.

36. Applying these criteria to the case at issue, the applicant did not have an habitual abode in Gameland because of the fact that it is not possible to consider the several hotels and the apartments where he stayed (for no more than 1 week) as an habitual abode. If we consider the element of the habitual abode as the place “where the individual regularly, normally or customarily lives”, it goes without saying that this requirement is not fulfilled if an individual changes the place of his stay every week, even though the several places are located within the same State.

37. On the other hand, the apartment located in Rainbowland could be considered not only as a permanent home but also as an habitual abode. In fact, when he was working abroad he returned to his hometown every weekend and, when he was fired from job, he left Gameland and came back to the apartment located in Rainbowland. These facts make it clear that for the taxpayer the latter apartment is considered to be the habitual abode.

### 3.6. Nationality.

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<sup>150</sup> A. RUST, as quoted in G. MAISTO, *Ibid.*, p. 389.

<sup>151</sup> J. SASSEVILLE, *Ibid.*, p. 166.

<sup>152</sup> *Ibid.*, p. 166.

<sup>153</sup> P. BAKER, *Ibid.*, p. 190; Lehner in Vogel/Lehner, *Doppelbesteuerungsabkommen*, op. cit., Art. 4 marg. note. 204.

38. If the Court reasoned that the apartment located in Rainbowland could not be seen as the place where the taxpayer regularly, normally or customarily lived, even fewer reasons exist for the opposite conclusion, namely that in the taxable year concerned the applicant regularly, normally or customarily lived in Gameland.
39. Therefore, since the taxpayer would not have an habitual abode in either State, under Art. 4(2) it would be necessary to apply the next tie-breaker rule, which refers to the criterion of the nationality. The latter criterion would be applicable also in case the applicant was considered to have an habitual abode in both States. As it is clear, the taxpayer is a national of Rainbowland, so he should be considered as a resident of the latter State.
40. Provided that the applicant has to be considered as a resident of Rainbowland, the Court may consider either Playland or Gameland as the source State. We will demonstrate that in both of these cases the taxing power has to be attributed to Rainbowland.

#### **4. Playland as the source State.**

41. Dealing with the first hypothesis, the Court may reason that all income received by the taxpayer when he was working abroad is to be considered as sourced in Playland. In fact, the applicant signed a freelance contract with Sonica, a company located in Playland, and he always received his remuneration from it. In addition, the case is pending before a Court of Rainbowland and this State has a much more formalistic approach and does not allow the re-qualification of the contract by the judiciary.
42. Given that there is no double taxation convention between Rainbowland and Playland, the former has no duty to give relief from juridical double taxation and it can levy taxes on the worldwide income of the taxpayer, including the remuneration paid by Sonica and the fringe benefits granted by Noentiendo (as they result from the contract that the taxpayer signed with Sonica).

#### **5. Gameland as the source State.**

43. Concerning the second hypothesis, the Court may consider Gameland as the source State. In this case, it would be necessary to apply the DTC which is in force between Rainbowland and Gameland; we will demonstrate that all the allocation rules applicable to the case at issue attribute the taxing power to Rainbowland.

#### **6. Allocation rules: Articles 7 and 5 of the DTC.**

44. According to the contract that he signed, the applicant shall be considered as a self – employed. In this case Art. 7 of the DTC shall apply: we will demonstrate that the applicant had no PE in Gameland under Art. 5 and therefore all his income shall be taxed in his residence country.

45. Art. 7 provides that business profits earned by a resident of one country are taxable in the other country only if the business is carried on through a PE located therein and the profits are attributable to that PE. The existence of a PE is a minimum condition that must be satisfied before a country can tax residents of other treaty countries on their business profits derived from the country.

46. Under Art. 5(1) the concept of PE is defined as “*a fixed place of business, through which the business of an enterprise is wholly or partly carried on*”. From this definition it derives that two conditions have to be met to create a PE: the existence of a fixed place of business and the fact that the business is carried on through this fixed place.

47. According to paragraph 5 of the OECD-Commentary to Art. 5 and under the general definition provided by Art. 5, the place of business has to be a “*fixed one*”. On the one hand, the traditionally accepted practice indicates that a place of business is fixed only if it remains at a distinct place or a particular site.

48. On the other hand, paragraph 5.1 of the Commentary introduces the concept of “*commercial and economic coherence*” to broaden the geographic criterion. In other words, when the nature of the business implies relocations, the notion of fixed place of business should be changed to the extent that the different locations are considered as a single geographical and commercial

coherent whole. However, according to the scholars<sup>154</sup> this rule seems to go far beyond a simple clarification of a concept already embodied in the Model. In fact, this concept tries to adapt something that is very well known in the construction PE clause to the basic PE notion. The fundamental characteristic of the construction PE is the existence of a working and installation project, which is the unique factor that leads to the possibility to broaden the geographic area where the activity is conducted. One should not overlook that this characteristic lacks with respect to the traditional PE concept. Based on this latter consideration, the broadening of the geographical link requirement does not respect either the wording of the treaty or the aim of the rule. Thus, the aggregation of different business locations, none of which individually constitute a PE, should not lead to a PE if combined.

49. Apart from this reasoning, the Commentary on Art. 5 itself provides an example, in paragraph 5.4, which remarks the necessity that the place of business, even if broadened by the coherence concept, shall always be distinct and spatially limited to a certain extent. In particular, the example refers to a consultant who works pursuant to a single project for training bank employees. If he works at different branches at separate locations – towns or villages, it may be presumed – each branch should be considered separately, not constituting a unique PE. In fact, paragraph 5.4 of the OECD-Commentary states that *“if the consultant moves from one office to another within the same branch location, he should be considered to remain in the same place of business. The single branch location possesses geographical coherence which is absent where the consultant moves between branches in different locations”*.
50. According to paragraph 6 of the Commentary, the fixed nature of the place of business implies a certain degree of permanency as well, i.e. the place of business shall have a “certain degree of permanency” instead of being of a purely temporary nature, in order to be fixed. The Commentary generally suggests a 6 months period and there is large consent among member States on this general practice. Nevertheless, the Commentary lists some deviations from this general rule, which can lead to the existence of a PE even in a shorter period of time. This can happen for instance when the nature of the business requires recurrent use of the place for short periods of time (extending over a number of years) or when the place of business was prematurely liquidated as a consequence of special circumstances.

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<sup>154</sup> A. CARIDI, *Proposed Changes to the OECD Commentary on Art. 5: Part I- The Physical PE Notion*, in *European Taxation*, IBFD, 2003, p. 13.



51. As we mentioned, the second condition to be fulfilled for the existence of a PE is that the business is carried on through the fixed place, which means that the latter must be at disposal of the enterprise<sup>155</sup>. A great debate was developed around the “at disposal” concept. For the large majority of commentators<sup>156</sup> the disposal condition is fulfilled when the enterprise is in a position to dispose over the PE in the sense that it cannot be excluded from using the place of business without its consent.
52. According to paragraph 4 of the Commentary “*the place of business may be situated in the business facilities of another enterprise. This may be the case for instance where the foreign enterprise has at its constant disposal certain premises or a part thereof owned by the other enterprise*”. The word “constant” implies that the “mere presence”, i.e. “a relatively sporadic or infrequent presence” in a given place is not enough to fulfil the disposal condition. In particular, it is stated that, due to the frequency of the use, the place should be identified with the enterprise which uses it. In addition, the mere presence does not seem to be linked to the duration and frequency of the use, but also to the weight of the business functions which are carried out at the given place: in some instances, notwithstanding the duration and frequency of the actions performed at the identified location, there is only “mere presence” because of the relatively minor significance of the services carried out in that place as compared to the whole business cycle. For this reason, the doctrine<sup>157</sup> specifies that “*in the case of a management or technical consultant who works for a certain period of time in his client’s office building or factory, these premises should be regarded as the consultant’s permanent establishment only if he uses his room or desk predominantly in his or his firm’s own interest. That would not be the case if, for example, he spent the vast majority of his time in meetings with the client or in instructing the client’s staff on the spot in using the production machinery or in optimizing the production processes*”.

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<sup>155</sup> OECD-Commentary on Art. 5, paragraph 4.

<sup>156</sup> J. SCHAFFNER, *The Territorial Link as a Condition to Create a Permanent Establishment*, in INTERTAX volume 41, 2013, p. 641; A. SKAAR, *Permanent Establishment: Erosion of a Tax Treaty Principle* (Boston/Deventer: Kluwer Law and Taxation Publishers, 1991), p. 158.

<sup>157</sup> J. LÜDICKE, *Recent Commentary Changes concerning the Definition of Permanent Establishment*, in BULLETIN – TAX TREATY MONITOR, IBFD, 2004, p. 192.

53. We will then apply the notions above to the case at hand in order to demonstrate that no PE exists in Gameland.
54. Having regard to the fixed place of business, even if the Court assumed that the concept of commercial and geographical coherence does not exceed the aim of the treaty, the place(s) of business – the rooms located into the different Noentiendo’s branches – shall not be considered to constitute a fixed place of business due to a lack of geographical coherence. In our opinion, this case falls precisely under the scope of the example provided in the Commentary to Art. 5. Indeed, since every branch possesses geographical coherence, each of them should constitute a PE. Unfortunately, the taxpayer rotated between the branches on a weekly basis: it derives that the permanence test for each of them cannot be fulfilled. Furthermore, the various branches of Noentinedo are not located within a spatially delimited territory, but in the whole jurisdiction of Gameland. With reference to this last statement, one should not underestimate the weight of the examples which are provided by the Commentary: to consider a whole jurisdiction as a geographically delimited area seems to go very distant from the wording of the Commentary which identifies a building or a delivery dock as the largest area which can be considered to be delimited<sup>158</sup>.
55. The permanence test shall be deemed to be not fulfilled as well. Firstly, the lack of geographic coherence makes it impossible to aggregate each period of time spent by the applicant in every single location. Secondly, even if the Court rejected this observation, for the purpose of evaluating the existence of a PE the taxpayer surely spent in Gameland less than 6 months<sup>159</sup> (general practice suggested by the Commentary<sup>160</sup>). Moreover it shall be observed that the taxpayer was not entitled to enjoy the deviations which are provided by the Commentary: the nature of the business is not of a recurrent character and the premature expiry of the contractual relationship was not caused by an unforeseeable event, since the taxpayer was known for his alcohol addiction before he signed the contract.
56. Concerning the disposal condition, from the wording of the case it can be inferred that the taxpayer had not a place of business at his disposal. He rotated between different rooms located

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<sup>158</sup> OECD-Commentary on Art. 5, paragraphs 4.4 and 4.5.

<sup>159</sup> See annex.

<sup>160</sup> OECD-Commentary on Art.5, paragraph. 6.

in different offices of Noentiendo, depending on the availability of them. Therefore he had not an unrestricted access to them. Furthermore he never spent more than one week in every single office. As stated above, this lack of duration both affects the disposal and the permanence tests: the presence of the taxpayer in every single office shall be considered as “sporadic and infrequent”. From this it derives that the condition of the “constant disposal” is not fulfilled. In addition it shall be highlighted that the taxpayer, by virtue of the contract, was entitled to do e-work from a touristic location using his laptop: as a consequence the different offices shall not be considered to be the only location through which the provider could execute his activity. One last reference must be made in respect of the nature of the services which the taxpayer provided: since he provided guidance to the programmers and other members of the staff of Noentiendo, his business functions shall be considered of a minor significance if compared to the whole business cycle. It derives that there was only a “mere presence”.

57. As a conclusion, in the case at hand the applicant did not fulfil any of the criteria which are needed for a “physical PE” to exist. Thus, all the taxpayer’s income shall be taxed in the residence state according to Art. 7.

## **7. On the applicability of Art. 15 of the DTC.**

58. The applicant could argue that, considering how things looked in practice, an employment relationship can be deemed to exist between himself and Noentiendo. Consequently, he may affirm that Art. 15 shall apply.

59. This argument would be totally ineffective. One should not overlook that the case at issue was brought before a Court applying Rainbowland’s domestic law. This one, as opposed to the national law of Gameland, has a much more formalistic approach, based on the idea of legal certainty, and it does not permit the re-qualification of the contract having regard to the substantial relationship which exists between the parties. Furthermore, under Rainbowland’s domestic law an employment relationship may only be formed by a written employment contract. Consequently, the assertion under which the freelance contract can be disregarded does not have any valid legal basis which can support it.

60. The taxpayer could argue again that in the case at issue we are in presence of a cross-border short-term assignment and that consequently, according to the Commentary, it is necessary to apply substance over form rules and to consider Noentiendo as the real employer. In this hypothesis, an employment relationship shall be recognized between the applicant and Noentiendo: Art. 15(1) shall apply, attributing the taxing rights to Gameland.
61. This assertion would be totally ineffective as well because it is based on an incorrect assumption, under which the 2010 version of the Commentary on Art. 15 can apply instead of the 2003 version. Only the former version allows the application of substance over form rules to short-term assignments, while the latter version refers such rules exclusively to abusive hiring-out of labour practices.

### 7.1. Interpretation of subsequent Commentaries.

62. It is necessary to adopt a static approach instead of a dynamic one in the interpretation of the Commentary. As we mentioned, the 2003 version provides for the application of substance over form rules when interpreting the terms “employer” and “employment” only with respect to abusive scenarios of international hiring-out of labour, not in respect of simple non-abusive short-term assignments.
63. Only a static interpretation of the Commentary complies with the general principles of legal certainty, *pacta sunt servanda* and legitimate expectations<sup>161</sup>. According to the doctrine, this rule is an indispensable rule of international law, expression of the principle of good faith which above all signifies the keeping of faith<sup>162</sup>. The principle of good faith is a fundamental principle from which the rule *pacta sunt servanda* and other legal rules distinctively and directly related to honesty, fairness and reasonableness prevail in the international community<sup>163</sup>. Also Art. 26 VCLT provides that every treaty in force is binding upon the parties to it and it must be performed in good faith.

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<sup>161</sup> F. ENGELEN, *Interpretation of tax treaties under international law*, IBFD, Volume 7 doctoral series, 2004.

<sup>162</sup> B. CHENG, *General principles of law as applied by international courts and tribunals*, 1953, reprinted in 1987, p.106.

<sup>163</sup> J. F. O’Connor, *Good faith in international Dartmouth* 1991.

64. Having regard to the wording of the Treaty and to the circumstances existing at the time it was concluded, taxpayers should be able to obtain certainty about their future tax obligations and it should not be possible to change those obligations to their disadvantage, unless that change has the same democratic legitimacy as the Treaty itself. The same Treaty provision should not be interpreted differently depending on when it is applied.
65. Subsequent changes to the articles of the OECD Model and to the Commentaries may be helpful as supplementary means of interpretation<sup>164</sup> in order to confirm the meaning based on the principle of good faith. However, such changes should nevertheless be treated with caution, particularly when referring to the Commentaries. In principle, the weight to be given to later OECD Models and Commentaries will depend on the extent of the changes made: the less substantial the changes, the greater the weight<sup>165</sup>.
66. When changes reflect the desire to clarify the text's meaning in the light of experience rather than to introduce new principles, it may be appropriate to consider the later OECD Commentary, even in relation to an earlier tax treaty. In contrast, if the new version of the Commentary differs widely from the previous one, it may be of no relevance<sup>166</sup>. In the latter situation, there is a stronger indication that the legitimate expectations of the taxpayers are frustrated if the new interpretation is to disadvantage for them.
67. Therefore, it is of a great importance to establish whether a particular change to OECD Commentaries qualifies as "clarifying" or "contradictory" in respect of the previous one. Secondly, it is required to take into account the position of the taxpayer under its domestic case law and the extent to which he could have anticipated the changes of the Commentary.
68. The issue of the importance of the Commentary on the OECD Model is a highly sensitive issue in general, but also in particular for the hiring-out of labour scenario as there have been several changes in the past. Regarding the question whether the OECD Commentaries apply to tax

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<sup>164</sup> Art. 32 VCLT.

<sup>165</sup> M. NIEMINEM, *Dual Role of the OECD Commentaries – Part I*, in INTERTAX, Volume 43, Issue 11 2015 Kluwer Law International BV, The Netherlands.

<sup>166</sup> D. BROEKHUIJSEN, K. VAN DER VELDE, *International / OECD The Retroactive Effect of Changes to the Commentaries on the OECD Model*, in Bulletin for International Taxation, 2015 (Volume 69), No. 11.

treaties concluded before the relevant Commentary, it is essential to look back at the historical development regarding the provisions dealing with the hiring-out of labour. After the 1984 Report and the 1992 update, non abusive scenarios were also meant to be included in the scope of assessment only in the Discussion Draft of 2004. This intention has been transposed by including a clearer concept of the term employer in the 2010 Commentary.

69. Since the 2010 changes of the Commentary on Art. 15 were of a radical nature, the taxpayer could not have anticipated them. Therefore, such changes did not simply clarify the text of the Commentary, thus they cannot be used as a mean of interpretation. From what is said above, it derives that the 2010 version of the Commentary on Art. 15 is not helpful for interpreting a Double Tax Treaty which was concluded in 2003. It is possible to refer only to the 2003 version.

## 7.2. The 2003 version of the Commentary.

70. As we mentioned, the latter version refers the application of substance over form rules, for interpreting the terms employer and employment, exclusively in respect of abusive international hiring-out of labour cases and not of simple *bona fide* short-term assignments.

71. It should be noted that, traditionally, the purpose of an abusive international hiring-out of labour practice is to formally fulfil the three conditions provided for in Art. 15(2) of the DTC, in order to attribute the taxing power to the State of residence and therefore to take advantage of the lower level of taxation that this State eventually practices, as opposed to the higher level which is applicable in the work State<sup>167</sup>. Thus, the abuse arises when there is such a difference in the level of taxation between the work State and the State of residence, whereby the application of the latter's domestic law would be more favourable for the worker than the application of the domestic law of the work State.

72. As regards our case, one should not overlook that an opposite situation arises: the State of residence (namely Rainbowland) has a level of taxation much higher than that applicable in the work State (namely Gameland). Therefore, the hiring-out of labour does not lead to tax savings

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<sup>167</sup> S. GOEYDENIZ, *IFA Research Paper: Tax Implications on International Hiring-Out of Labour / Hiring-Out of Labour - still the poor relation in double tax conventions?!*, IBFD, 2010, p. 7.

for the applicant and does not constitute an abuse, with regard to the specific situation that we are dealing with.

73. Hence, the substance over form rules contained in the 2003 version of the Commentary on Art. 15 cannot apply for the simple reason that in our case there is not an abuse.

74. In consequence, the terms “employer” and “employment”, not being defined by the Convention, are to be interpreted exclusively with reference to the domestic law of the State applying the Treaty (namely Rainbowland). In fact, according to Art. 3(2) of the DTC, “*As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies*”. With respect to the phrase “*unless the context otherwise requires*”, applying the 2003 version of the Commentary, it is clear that the context requires an alternative interpretation only in the case of abuse.

75. As it is known, Rainbowland adopts a formalistic approach regarding what should be considered an employment contract. Under its domestic law, an employment relationship may only be formed by a written employment contract, named as such, and freelance contracts may not be re-qualified by the judiciary as employment contracts.

76. Hence, Art. 15 is not applicable because in the case at issue the applicant signed a freelance contract, not an employment one, and his income constitutes income from self-employment.

### **7.3. The 2010 version of the Commentary**

77. Even if the Court considered the 2010 version of the Commentary as applicable, it would nonetheless be irrelevant in respect of our case.

78. This version covers not only abusive cases of international hiring out of labour but also non abusive short term assignments<sup>168</sup>, which require the same conduct (from an objective perspective) but without any indication of abuse. They are the so-called *bona fide* short-term assignments and the transaction carried out among Super Dario, Noentiendo and Sonica belongs to this category.
79. Therefore, one could argue that applying the 2010 version of the Commentary leads to the conclusion that, when interpreting the terms employer and employments, substantial criteria shall apply and, with respect to our case, Noentiendo shall be regarded as the real employer of the applicant; the consequence would be that an employment relationship would be deemed existent and Art. 15 of the DTC would apply.
80. An argument like this would not be valid. The 2010 Commentary on Art. 15 clearly distinguishes between States whose domestic law adopts a formalistic approach when interpreting the term "employer" and States whose domestic law adopts a substantial approach<sup>169</sup>. After this distinction, the Commentary provides for the application of substantial criteria exclusively for the latter States; the former States are only free to adopt a bilateral tax treaty provision based on substance over form rules, but from the Commentary we infer that if these States did not adopt such a provision, they are authorized (or rather they are obliged by their domestic law) to continue applying formal criteria.
81. In fact, from paragraph 8.8 of the Commentary on Art. 15 it derives that if States adopting a formal approach did not include a specific provision dealing with the matter at issue, they are nonetheless free to adopt substantial criteria in abusive cases; *a contrario*, we infer that if there is not either an abuse, the application of substantial criteria by these States is precluded<sup>170</sup>.

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<sup>168</sup> OECD-Commentary on Art. 15, paragraph 8.1; S. GOEYDENIZ, *Ibid.*, p. 16; K.DZIURDZ and F. POTGENS, *Cross-Border Short-Term Employment*, in *Bulletin for international taxation*, 2014, p. 409; D. VAAN WEEGHEL, *The 2010 OECD Updates, Model Tax Convention & Transfer Pricing Guidelines A Critical Review*, in *Kluwer Law International*, 2010, p. 129.

<sup>169</sup> OECD-Commentary on Art. 15, paragraphs 8.3 and 8.4; See also F. P.G. POTGENS, *Proposed changes to the Commentary of art. 15(2) of the OECD Model and their effect on the interpretation of "employer" for treaty purposes*, in *Bulletin for international taxation (2007)*, p. 478; E. BURGSTALLER, *Employer' Issues in Article 15(2) of the OECD Model Convention ± Proposals to Amend the OECD Commentary*, in *INTERTAX*, 2005, p. 124.

<sup>170</sup> S. GOEYDENIZ, *Ibid.*, p. 16.



82. Rainbowland belongs to the category of Contracting States adopting formal criteria and in the DTC concluded with Gameland the parties did not include a specific rule dealing with short-term assignment cases. In addition to this, as we mentioned, in the case at issue there is not an abuse which can be counteracted by Rainbowland. Therefore, this State is not obliged to apply substantial criteria but has to apply its domestic law, based on formal concepts of the terms employment and employer.
83. The application of formal criteria is endorsed by part of the doctrine<sup>171</sup> and the jurisprudence<sup>172</sup>. Paying attention to the latter, in several cases the Swedish fiscal jurisprudence accorded relevance to the domestic, formal concept of the term “employer”, sustaining that the “context” (to which Art. 3(2) of the DTC refers) does not require an alternative and economic meaning. An important position, which is in line with the provision of the Commentary, was assumed by Switzerland. It registered a reservation to the OECD Model Commentary, taking the view that the economic approach referred to in the OECD Commentary should be reserved for cases of abuse of international hiring-out of labour. Thus, it is unlikely that Switzerland will apply a purely economic approach when interpreting the terms employer and employment<sup>173</sup>.
84. The applicant could observe that the Commentary<sup>174</sup>, after having introduced the distinction between the two categories of Contracting States quoted above, establishes that “*it is a matter of domestic law of the State of source to determine whether services rendered by an individual in that State are provided in an employment relationship and that determination will govern how that State applies the Convention*”. Since Gameland's domestic law adopts a substantial approach, it would interpret the concrete relationship between the applicant and Noentiendo as an employment relationship and it would consider the latter company as the real employer. Consequently, as opposed to Rainbowland, Gameland would apply Art. 15 instead of Art. 7. At that point a conflict of qualification between these two States would arise and, under Art. 23(A)

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<sup>171</sup> R. WALDBURGER, *Income from Employment (Article 15 OECD Model Convention)* (2008) published in *Source versus Residence – Problems arising from the Allocation of Taxing Rights in Tax Treaty Law and Possible Alternatives*, edited by LANG M., PISTONE P., SCHUCH, JOSEF AND STARINGER, KLAUS, WOLTERS KLUWER LAW & BUSINESS, ALPHEN AAN DEN RIJN, 2008. Cit: [Waldburger (2008)], p. 186 et seq.

<sup>172</sup> See, for example, the Swedish *White Arkitekter case* (case number 901-02-07.); the Swedish *Dansico Sugar cases* (case number 9837-07, case number 1780- 09, case number 2311-09 and case number 2587-09).

<sup>173</sup> L. DE BROE et al, *Interpretation of Article 15(2)(b) of the OECD Model Convention: “Remuneration Paid by, or on Behalf of, an Employer Who is not a Resident of the Other State*, in IBFD, 2000, p. 510.

<sup>174</sup> OECD-Commentary on Art. 15, paragraph 8.4.

of the DTC, Rainbowland should grant the exemption because paragraph 32.3 of the Commentary on Art. 23 imposes to follow the qualification of the source State.

85. This argument would be totally ineffective as well. Indeed, regarding the Commentary on Art. 15<sup>175</sup>, it refers only to the State of source and not to the State of residence. It clarifies that the qualification adopted by the State of source “*will govern how that State applies the Convention*”, but the position of the State of residence is not addressed.
86. Furthermore, as regards Art. 23A and its Commentary, it is correct to say that the State of residence is obliged to follow the qualification of the State of source; however, this must happen only in the case in which the latter State actually “*applies, with respect to a particular item of income or capital, provisions of the Convention that are different from those that the State of residence would have applied to the same item of income or capital*”. Hence, it is necessary that the State of source has already applied a provision of the Convention.
87. From the facts of the case we know that in 2012 the applicant did not file any tax return in Gameland and that the latter did not make any assessment. Therefore, a conflict of qualification between Gameland and Rainbowland, within the meaning of paragraph 32.3 of the Commentary on Art. 23A, actually does not arise and Rainbowland is not obliged to follow a qualification that Gameland only in theory would adopt if it made an assessment. In other words, the situation considered by the Commentary on Art. 23, where the State of source has already applied its own qualification and the State of residence must follow it, is completely different from our case, where the State of source did not apply any qualification and the State of residence is going to apply the Convention.
88. For all these reasons, we suggest the Court to deny the existence of an employment relationship between Noentiendo and Super Dario and to deny the application of Art. 15 of the DTC.

## **8. Taxation of image rights under Art. 12 of the DTC.**

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<sup>175</sup> Ibid.

89. If the Court rejected the defendant’s previous arguments, it must be affirmed anyway that the income of the applicant shall be taxed in the residence State under Art. 12 of the DTC as royalties paid for the exploitation of his image rights.

### **8.1. Scope of Art. 12 of the DTC and its applicability to the case at issue.**

90. Art. 12(1) of the DTC states that royalties shall be taxed in the State of residence of the beneficial owner<sup>176</sup>. In the following paragraphs, we will illustrate firstly that payments for the exploitation of image rights shall be considered as royalties; then, we will explain which is the meaning of the expression “beneficial owner”. Finally, we will demonstrate why these concepts are relevant for the case at issue.

91. As specified by Art. 12(2), the OECD uses a broad definition of the term “royalties”, because it *“means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience”*. Moreover, the Commentary on Art. 12 makes it clear that *“the definition applies to payments for the use of, or the entitlement to use, rights of the kind mentioned, whether or not they have been, or are required to be, registered in a public register”*<sup>177</sup>.

92. The so-called “right of publicity” is the right of an individual to dispose of the economic value of his identity (especially his name, image, likeness). It is grounded on property rationales and it prohibits the exploitation of the identity without the permission of its owner<sup>178</sup>. Courts worldwide recognize, with little differences, the importance of the right to publicity<sup>179</sup>: for example the US Supreme Court recognized it in the *“Zacchini v. Scripps-Howard Broadcasting Co.”* case in 1977<sup>180</sup> and then this principle was reaffirmed by several others sentences of lower

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<sup>176</sup> OECD-Commentary on Art. 12, paragraph 3.

<sup>177</sup> OECD-Commentary on Art. 12, paragraph 8.

<sup>178</sup> For a general definition under US law see: Restatement (Third) of Unfair Competition paragraph 46.

<sup>179</sup> e.g. *Cour de cassation*, 1re chambre civile, 24 septembre 2009 no 08-11.112, *Cour de cassation*, 1re chambre civile, 9 juillet 2009, no 07-19.758 in France; *Entscheidungen des Bundesgerichtshofs in Zivilsachen* 13,334; BGH NJW-RR 1987, 231 in Germany.

<sup>180</sup> *Zacchini v. Scripps-Howard Broadcasting Co.*, 433 U.S. 562, 1977.

US Courts<sup>181</sup>. The International Trademark Association<sup>182</sup> and also the jurisprudence<sup>183</sup> compared the protection of the right of publicity to the protection of trademarks and property<sup>184</sup>. For these reasons, the payments received for the exploitation of image rights can be considered as royalties.

93. The Commentary clarifies that also the term “*beneficial owner*” shall be interpreted in a broad sense<sup>185</sup>. In some cases, it may happen that “*the direct recipient of the royalties is not the “beneficial owner” because that recipient’s right to use and enjoy the royalties is constrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the royalties unconstrained by a contractual or legal obligation to pass on the payment received to another person*”<sup>186</sup>. All the member States of the OECD and the Commentary agree with the fact that the exemption from taxation in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer, in those cases in which the beneficial owner is a resident of the other Contracting State<sup>187</sup>.

94. Most part of the jurisprudence<sup>188</sup> of OECD countries agrees that formal factors are not relevant to determine who is the “beneficial owner”: it is necessary to have regard to the economic substance of the affair. Also administrative and legislative bodies of many developing countries agree with this approach<sup>189</sup>. Scholars substantially follow this “economic approach” to the matter. For instance Vogel states that “*beneficial owner is one who is free to decide (1) whether*

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<sup>181</sup> e.g. *White v. Samsung Electronics America, Inc.*; *Hoffman v. Capital Cities/ABC, Inc.*

<sup>182</sup> See the Board resolution of INTA on US federal right of publicity by Right of Publicity Subcommittee of the Issues and Policy Committee of the 03/03/1998.

<sup>183</sup> *Motown Record Corp. v. Hormel & Co.* 849 F.2d 460, 463 (9th Cir. 1988).

<sup>184</sup> *Acme Circus Operating Co. v. Kuperstock*, 711 F.2d 1538, 1541 (11th Cir. 1983); *Unhlaender v. Henricksen* 316F; *Presley v. Crowell*, 733 S.W.2d 89, 97.

<sup>185</sup> OECD-Commentary on Art. 12, paragraph 4.

<sup>186</sup> See. 2014 OECD-Commentary on Art. 12, paragraph 4.3.

<sup>187</sup> OECD-Commentary on Art. 12, paragraph 4.2.

<sup>188</sup> e.g. *Bank of Scotland Conseil d’Etat*, 29 Dec. 2006, Case 283314) in France; *Real Madrid FC* (2006) Case 1110/2003 in Spain; *HHU case SKM 2011.57* in Denmark; *HFD* (21 May 2012) not. 24 in Sweden; *Indofood International Finance Limited v. JP Morgan Chase Bank, N.A., London Branch*, [2006] in UK.

<sup>189</sup> *Guoshuihan*, 2009 No. 601 (Circular 601) for China; paragraph 26(1) of Law 12249/2010 for Brazil; Regulation PER-62/PJ/2009 of November 2009 for Indonesia.

*or not the capital or other assets should be used or made available for use of others or (2) on how the yields there from should be used or (3) both*<sup>190</sup>. In the same sense, among others, Danon<sup>191</sup> and Charles du Toit<sup>192</sup>. For these reasons, we suggest the Court to follow a substance over form approach in interpreting the term “beneficial owner”, according to scholars and jurisprudence worldwide.

95. In the case at issue, firstly it shall be noted that Noentiendo wanted to hire the taxpayer to exploit his notoriety of former kart pilot and *viveur*: the CEO of Noentiendo clearly admitted that he wanted to attract the attention of Rainbowland’s media onto his society (so to buster its games’ sale) thanks to the indirect publicity assured by the applicant. Secondly, the relevance of the social notoriety of the applicant in the contractual relationship between the parties can be also implied looking at how the contract has been terminated. In fact, Noentiendo decided to terminate the contract when it discovered that, thanks to the reports of several social magazines, the applicant returned to drinking and to use drugs. For these reasons, it is clear that a relevant part of the income of the applicant did not derive from employment or freelance activities, but also from the exploitation of his image rights by Noentiendo. It is necessary to affirm that all the parties made a silent agreement which stated that part of the income of the taxpayer depended from his social notoriety and behaviour. This income shall be taxed as royalties because it derived from the exploitation of the image of the applicant. Thus, it can be associated to the use of a trademark or intellectual property copyrights (as said above, the Commentary states that the registration in a public register of the right is not relevant).
96. According to the substance over form approach, which arises from Art. 12 and its Commentary, in the case at issue Sonica must be regarded as a mere intermediary between the payer of the royalties, namely Noentiendo, and the beneficiary, namely the applicant. Since the remuneration of Sonica’s business was a 5% surplus fee based on gross cost, the remaining part of the amount paid by Noentiendo (i.e. all the income received by the taxpayer) shall be substantially considered as a royalties payment made to the applicant himself through Sonica, which had the binding obligation to transfer it to the taxpayer according to the contract.

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<sup>190</sup> K. VOGEL, *ibid.* p 562.

<sup>191</sup> R. DANON, “*Clarification of the meaning of “Beneficial Owner” in the OECD Model Tax Convention- Comment on the April 2011 Discussion Draft*”, *Bulletin for International Taxation*, Vol. 65 (August 2011) no 8, pp 437-442.

<sup>192</sup> Charl du Toit, “*The evolution of the term “Beneficial Ownership” in relation to international taxation over the past 45 years*”, *Bulletin for International Taxation*, Vol. 64 (2010) no 10, pp 500-509.

## 8.2. Non applicability of Art. 12(3) of the DTC.

97. Art. 12(3) contains a general exception to the rule of the first paragraph, regarding the case in which *“the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise through a permanent establishment situated therein and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply”*. In the following paragraphs we illustrate why this exception does not apply to the case at issue, since the applicant did not have any PE in Gameland.

98. The Commentary on this provision narrows the scope of the concept of PE: it specifies that there is not any *“force of attraction of the permanent establishment. It does not stipulate that royalties arising to a resident of a Contracting State from a source situated in the other State must, by a kind of legal presumption, or fiction even, be related to a permanent establishment which that resident may have in the latter State”*<sup>193</sup>. Moreover, at paragraph 21.1, the Commentary states that the *“right or property in respect of which royalties are paid will be effectively connected with a permanent establishment, and will therefore form part of its business assets, if the “economic” ownership of that right or property is allocated to that permanent establishment under the principles developed in the Committee’s report entitled Attribution of Profits to Permanent Establishments”*.

99. This report<sup>194</sup> and the Commentary on Art. 7(2)<sup>195</sup> clarifies that the economic owner of a right is the one who has the *“ownership for income tax purposes by a separate enterprise, with the attendant benefits and burdens (e.g. the right to the royalties attributable to the ownership of the right or property, the right to any available depreciation and the potential exposure to gains or losses from the appreciation or depreciation of that right or property)”*.

100. The defendant has already explained why the applicant had not any permanent establishment in Gameland<sup>196</sup>. Anyway, it must be said that, even if the applicant had a permanent establishment for the taxation of business profits, he did not have one for the purpose

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<sup>193</sup> OECD-Commentary on Art. 12, paragraph 20.

<sup>194</sup> *Attribution of Profits to Permanent Establishments*, OECD, Paris, 2010, in particular paragraphs 72-74, 76-91,96-97.

<sup>195</sup> OECD-Commentary on Art. 7, paragraphs 15-23.

<sup>196</sup> See paragraphs 44 et seq. of this memorandum.

of article 12: in fact, in the case at issue, the applicant did not have “*the right to any available depreciation and the potential exposure to gains or losses from the appreciation or depreciation of that right or property*” of his image rights (one of the core elements to define the “*economic ownership*”); instead, the subject exposed to such depreciation was Noentiendo, whose business eventually suffered by the taxpayer’s bad behaviour. For these reasons, we suggest the Court to only apply Art. 12(1), not considering applicable Art. 12(3) of the DTC.

## **9. Non applicability of Art. 17 of the DTC.**

*101. In this paragraph we will demonstrate that the applicant shall not be taxed under Art. 17 because the requirements of this provision are not satisfied.*

*102. Neither this article nor the Commentary give a general definition of “sportsman”. The definition of this term therefore results from interpretation. Generally, an individual shall be considered as a sportsman if he is engaged in some physical activity from which an income derives.*

*103. In the present case, it is of clear evidence that the applicant does not fall into the scope of the term since his contractual relationship with Noentiendo is not based on performances related to physical activities. Furthermore, the Commentary on Art. 17<sup>197</sup> requires a close connection between the income and the performance of the activities to exclude the application of other treaty provisions. Such a close connection will generally be found to exist where it cannot reasonably be considered that the income would have been derived in the absence of the performance of these activities. In the case at hand the requirement of a close connection is not fulfilled, therefore the income cannot be qualified as income from sport activities*

*104. The taxpayer may claim that he was hired by Noentiendo’s CEO as a freelancer in order to attract the attention of Rainbowland’s media onto his company and, thus, to support the marketing of its games. This assertion could be made in order to prove that he could at least be considered as an entertainer since his image would be used to promote the game. However, the definition of entertainer in Art. 17 is very narrow and does not include every type of entertainers.*

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<sup>197</sup> OECD-Commentary on Art. 17, paragraph 9.

105. Since the applicant was not famous for his racing career but for his social life, he should be treated as a celebrity rather than as an entertainer. In fact, he did not make any public performance whose predominant element was of an artistic and entertaining nature.

106. In conclusion, Art. 17 shall not be applied to the case at hand, since the taxpayer cannot be seen either as an entertainer or as a sportsperson.

## **10. Conclusions.**

107. We have demonstrated that in 2012 the taxpayer was a resident of Rainbowland and all of his income was sourced in Playland. If the Court shared this assertion, the applicant shall be taxed in Rainbowland since there is not a DTC in force between the two States concerned. On the other hand, if the Court considered Gameland as the source State, the DTC concluded with Rainbowland shall apply. All the relevant allocation rules contained in the Convention attribute the taxing right to the latter State.



## VII. Annex

### TOTAL AMOUNT OF DAYS SPENT BY THE TAXAYER IN EACH COUNTRY

#### 4. Total amount of days spent in Rainbowland:

- Every weekend (Saturday and Sunday) from the 7<sup>th</sup> of January 2012 to the 17<sup>th</sup> of June = 58 days;
- From the 21<sup>st</sup> of June 2012 to the 31<sup>st</sup> of October 2012 (included) = 123 days.

Total amount of days spent in Rainbowland = **181**.

#### 5. Total amount of days spent in Gameland:

- From the 1<sup>st</sup> of January 2012 to the 20<sup>th</sup> (included), not taking into consideration every weekend from the 7<sup>th</sup>/8<sup>th</sup> of January 2012 (= 124 days);
- From the 1<sup>st</sup> of November 2012 to the 31<sup>st</sup> of December 2012 (period of rehab in the clinic) = 61 days.

Total amount of days spent in Gameland = **185**.

#### 6. Total amount of days with reference to the PE:

- 166 days (including the weekends in Rainbowland). This calculation is made taking into consideration the provisions contained in paragraphs 6.1, 11 and 19 of the OECD-Commentary to Art. 5.
- 120 days (not including the weekends in Rainbowland).

## **VI. Table of Abbreviations**

Art(s)..... Article(s);

DTC..... Double tax convention between Rainbowland and Gameland;

OECD ..... Organization for Economic Co-Operation and development;

OECD-MC ..... OECD Model Convention;

CVI..... Centre of Vital Interest;

PE ..... Permanent Establishment;

VCLT..... Vienna Convention on the Law of Treaties.