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NOTE ON DRAFT OF COMMENT UPDATE OF ARTICLE 5 ON DIGITAL ACTIVITIES

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This note referrers to the draft of comment update that was made public after the 20th session. Rationale is presented for a digital activity nexus and a formulary apportionment.

Doc E/C.18/2020/CRP/10

Update of the UN Model Double Taxation Convention between Developed and Developing Countries – Proposed changes to the Commentary on Article 5 (Permanent Establishment).

RELEVANT KEY FINDINGS IN THE DRAFT OF COMMENT UPDATE :

- p. 4, # 1 : Article 5 of the United Nations Model Convention is based on Article 5 of the OECD Model Convention but contains several significant differences (..) :
    - ..a delivery activity might result in a permanent establishment under the United Nations Model Convention without doing so under the OECD Model Convention ;
    - the actions of a 'dependent agent' may constitute a permanent establishment, even without that person habitually conclude or habitually playing the principal role leading to the conclusion of, certain contracts to be performed by the foreign enterprise, (..)

Comments on § 1 :

- p. 5, # 3 :
    - **'place of business**' : a facility such as premises or, in certain instances, machinery or equipment,

      # 10 => whether or not they are used exclusively for that purpose,
      # 36 : However, it is provided that the term 'enterprise' applies to the carrying on of any business. (..) The Convention does not contain an exhaustive definition of the term 'business', which, under paragraph 2, should generally have the meaning which is has under the domestic law of the State that applies the Convention (..) Issues may arise concerning the application of the definition of permanent establishment to facilities such as cables or pipelines that cross the territory of a country (..) A separate question is whether the cable or

pipeline could constitute a permanent establishment for the customer of the operator of the cable or the pipeline, i.e. **the enterprise whose data**, power or energy **is transmitted** or transported from one place to another. In such a case, the enterprise is merely obtaining transmission or transportation services provided by the operator of the cable or pipeline and does not have the cable or pipeline at its disposal. As a consequence, the cable or pipeline cannot be considered to be a permanent establishment of that enterprise.

- '**fixed'** : it must be established at a distinct place with a certain degree of permanence,

  # 21 => it is enough that the equipment remains on a particular site
  # 22 => a single place of business will generally be considered to exist where, **in light of the nature of the business**, a particular location within the activities are moved may be identified **as constituting a coherent whole commercially and geographically with respect to that business**
  # 28 => to exist only if the place of business has a certain degree of permanency
  # 29 => One exception to this general practice has been where the activities were of a recurrent nature, in such cases, each period of time during which the place is used needs to be considered in combination with the number of times during which that place is used
  # 34 => Where a place of business which was, at the outset, designed to be used for such a short period of time that it would not have constituted a permanent establishment but is in fact maintained for such a period that it can no longer be considered as a temporary one, it becomes a fixed place of business and thus – **retrospectively** – a permanent establishment.

- **'the carrying of the business of the enterprise through this fixed place of business**' : must have productive character, i.e. contribute to the profits of the enterprise.

  #35 : operations must be carried out on a regular basis

- # 8 : .. that the way in which business is carried on evolves over the years;
- # 9 : .. must be made independently from the determination of which provisions of the Convention apply to the profits derived by that enterprise..

Comments on § 4.1 :

- # 63 : In 2017 the Committee decided to adopt a new paragraph 4.1 in Article 5 (..) Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status) (..) from fragmenting its activities

Comments on § 5 :

- # 65 : It is generally accepted that, if a person acts in a State for an enterprise in such a way as to closely tie up the activity of the enterprise with the economic life of that State, the enterprise should be treated as having a permanent establishment in that State – **even if it does not have a fixe place of business in that State under paragraph 1. Paragraph 5 achieves that by deeming a permanent establishment to exist if the person is a so-called dependent agent** who carries out on behalf of the enterprise an activity specified in subparagraph (a) or (b) (..) because such activities create for that enterprise a sufficiently close association with a State.
- # 67 ; In relation to subparagraph (a), a dependent agent causes a "permanent establishment" to be deemed to exist only if that person repeatedly, and not merely in isolated cases, concludes contracts (..)

Comments on § 7 :

- # 74 : (..) Where, for example, the sales that an agent concludes for enterprises to which it is not closely related represent less than 10 per cent of all the sale that is concludes as an agent acting for other enterprises, that agent should be view as acting "exclusively or almost exclusively" on behalf of closely related enterprises.

Comments on § 9 :

- # 78 : (..) It provides that a person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons of enterprises

Electronic commerce : # 79 & 80

..as to whether the mere use in electronic commerce operation of computer equipment in a country could constitute a permanent establishment (..) an e-tailer that carries on the business of selling products through the internet. (..) **What needs to be done in such a case is to examine the nature of the activities performed at that location in the light of the business carried on by the enterprise**. (..) it is common for Internet Service Providers to provide the service of hosting the web sites of other enterprises on their own servers (..) the ISP's will not constitute an agent of the enterprise (..) because they will not conclude contracts.. (..) **that some business could seek to avoid creating a permanent establishment by managing the contractual terms in cases where the circumstances would justify the conclusion that a permanent establishment exists. Such abuses may fall under the application of legislative or judicial anti-avoidance rules.**

INPUT

Question # 1 : How does presence triggered by national judges under national non-tax law requirements on digital activities affect in turn the interpretation of tax treaties with regard to a permanent establishment under the draft of comment update for paragraphs 1, 5 or 9?

1. This question relates to multiple court rulings that occurred since the 2017 OECD and UN Model Double taxation Convention update was made public. These court rulings compare in labor, trade and competition law the effects of an economic activity that is digitally organized with the effects of a similar non-digitally organized economic activity. In substance, digitally organized economic activity is checked on the effects of exerting decisive and effective control over transactions with or actions from national subjects in the national territory.

A. French Cour de cassation 4th March 2020 ruling (# 374, ECLI:FR:CCAS:2020:SO00374) in Uber France v. M. A..X.. : platforms that organize transportation of persons :

2. An independent contractor in France who provides transportation services of persons in the French territory through the platform run by UBER BV in Holland is deemed to be an employee of UBER BV (Dutch resident company).

The following facts were considered proven and relevant to motivate that ruling:

- The driver has joined a transportation service of persons in France that was created and entirely organized by UBER BV.
- The provided service of transportation in France only exists through the platform of that company.
- The use of that platform does not provide the driver with own customers, does not allow him to fix his rates nor set the conditions for the transport he provides.
- The platform dictates what clients to pick up where and how to drive towards them and the platform reduces income when the driver does not follow the road chosen by the platform in order to join the clients.
- Sometime the driver does not know where that road will lead him or too who, so he has no choice of his own free will to decide if that transportation service suits him, as an independent driver would have been able to decide.
- The platform can refuse access to the driver if he refuses three times to follow the instructions of the platform or when the platform observes an 'unbecoming behavior'.

These proven facts create in the view of the French High Court (Cour de Cassation) a similar context as that of an employer that has the power to give orders and instructions to the driver, to control the execution of said orders and instructions, and to sanction when not complied with. So that driver must be considered equal to an employee, bound by a French labor law contract to that company that operates that platform that provides transportation services of persons in France.

⇨ Could following a similar ruling as **under French national labor law** that employee create in turn a permanent establishment for UBER BV in France, allowing France to

submit the Dutch resident company UBER BV to French corporate income taxes if the UN TAX MODEL CONVENTION was to apply in that context?

⇨ And if so, under what paragraph of Article 5 would the Committee qualify in its comment update on Article 5 such a permanent establishment: through the general criterion (paragraph 1) and/or through the dependent agent criterion (paragraph 5) and/or other criterions such as paragraph 9 (control)?

B. SCOCAL 30 April 2018 ruling, '*Dynamex operations West Inc. v. Superior Court,* S222732 : platforms that organize transportation of goods:

3. In a ruling of 30 April 2018, the Supreme Court of California (SCOCAL) considered the following with regard to an enterprise that delivers purchased goods and picks up returned goods by using independent contractors as drivers:

- Prior to 2004, the Californian drivers of that enterprise were employees.
- In 2004, all drivers were converted to independent contractors after management concluded that this conversion would generate economic savings for the company.
- All drivers are treated as independent contractors and are required to provide their own vehicles and pay for all their transportation expenses, including fuel, tolls, vehicle maintenance, and vehicle liability insurance, as well as all taxes and workers' compensation insurance.
- The company obtains its own customers and sets the rates to be charged to those customers for its delivery services. It also negotiates the amount to be paid to drivers on an individual basis.
- Drivers are paid a flat fee or an amount based on a percentage of the delivery fee that the company receives from the customer.

The verdict of SCOCAL was that there is no independently established business since the customers, the charged rates, the pick-up and delivery points, and the tracking of the transported goods are decided by the enterprise through its tracking and record keeping system.

The Supreme Court of California considered that business that uses independent contractors **in a similar way as workers** does not bear any of the costs and responsibilities of many state and federal statutes and regulations. The public may be required under applicable laws to assume additional financial burdens with respect to such workers and their families when they fall in need. An unfair competitive advantage is thus obtained over competitors that properly consider similar workers as employees and that thereby assume the fiscal and other responsibilities and burdens that an employer owes to his employees. The fact that such practices have increased nationwide deprives federal and state governments of billions of dollars in tax revenue and millions of workers of the labor law protection they are entitled.

⇨ Could following a similar ruling as **under the U.S. California State labor law** a permanent establishment for foreign companies be triggered, allowing the USA to submit that foreign company to USA corporate income taxes, if the UN TAX MODEL CONVENTION was to apply in that context?

- ⇨ And if so, under what paragraph of Article 5 would the Committee qualify in its comments on Article 5 such a permanent establishment: through the general criterion (paragraph 1) and/or through the dependent agent criterion (paragraph 5) and/or other criterions such as paragraph 9 (control)?

C. CJEU 20 December 2017 ruling in case C-343/15, Asociación Profesional Élite Taxi v. Uber Systems Spain SL, ECLI:EU:C:2017:981 : service of transportation of persons :

4. In a ruling of 20 December 2017, the Court of Justice of the European Union (CJEU) described Uber's business model as that of a provider of services (§ 39) that operates in a European Member State through independent contractors providing the service of transporting persons:

- the selection of non-professional drivers using their own vehicles, in an application without which (i) those drivers would not be led to provide transport services, and (ii) persons would not use them,
- decisive influence over (i) the maximum fare by means of the eponymous application, whereby the company receives the fare from the client before paying part of it to the non-professional driver of the vehicle, and (ii) the quality of the vehicles, the drivers and their conduct, which, in some circumstances, can result in their exclusion.

UBER had claimed it was just a go between and that the Spanish independent contractor was providing in his own name that service of transportation. The CJEU ruling stated that UBER was the company providing that service in Spain and not the Spanish independent contractor. The case was then sent back to the Spanish Court that had asked an interpretation on EU law.

The UBER subsidiary in Spain had no significant turnover allocated to it by the group. Payments of passengers in Spain were transferred from their bank accounts to a bank account in the Netherlands owned by UBER BV. After deduction of a fee, the remaining part went to the bank account of the contractor who provided the service. Under Dutch tax law a royalty deduction further allowed to transfer that commission nearly untaxed to an Irish subsidiary of UBER.

- ⇨ This decision places under EU law the entire service in the source state as provided by a non-resident company. The Spanish driver is considered a sub-contractor of UBER BV for **EU law** ; the CJEU was not requested to rule on labor-law interpretation.
- ⇨ Under what paragraph of Article 5 would the Committee qualify in its comment update on Article 5 this ruling ? Through the general criterion (paragraph 1) and/or through the dependent agent criterion (paragraph 5) and/or other criterions such as paragraph 9 (control) ?

D. Delhi High Court in non-tax disputes, *World Wrestling Entertainment, Inc v. Reshma Collection & Ors*., 2014 SCC OnLine Del 2031 : e-tailer is present :

5. The terms "*carries on business in Delhi*" were satisfied when the appellant's customers were located in Delhi, accessed the website in Delhi, communicated their acceptance to the

offer of merchandise advertised on the website, at Delhi, and received the merchandise in Delhi, even though the server for the appellant's website was not located in Delhi. This court ruling held that the availability of transactions through the website at a particular place is virtually the same thing as a seller having shops in that place in the physical world.

- ⇨ Could a similar ruling as under **Indian national trade law** that qualifies the digital activities of an 'e-tailer' as similar to that of a retailer for procedural purposes, create a permanent establishment for that company if not present in India, allowing India to submit it to Indian corporate income taxes if the UN TAX MODEL CONVENTION was to apply in that context?
- ⇨ If that company was not established in India, under what paragraph of Article 5 would the Committee qualify in its comments on Article 5 such a permanent establishment: through the general criterion (paragraph 1) and/or through the dependent agent criterion (paragraph 5) and/or other criterions such as paragraph 9 (control)?

6. The four cited court cases treat digital activity as non-digital physical activity because of the decisive and effective control over the transaction itself (Indian & CJEU cases place the transaction on the market jurisdiction) and over the national person involved in it (French & USA cases qualify the person involved as an employee). Nothing excludes that in the nearby feature similar rulings will occur in various jurisdictions. The right to tax may follow.

Other non-tax law requirements that lead to physical presence could result from the obligation for information society service providers to allow access to national authorities to a terminal located on the national territory. The presence of such a terminal could be required in order to enforce national laws and national court decisions that relate to removing or adapting information stored on a server located in another territory but accessible to the general public in that jurisdiction. This could relate to fake news, protection of privacy, quick deleting of nude pictures of minors, images of self-inflicted wounds, animal torture etc.. that are generally accessible in the national language from the national territory.

Facebook employs over 1.000 persons in Germany in order to comply with the German law that forces Facebook to clean up within the 24 hours of publishing content posted by its users that is considered unlawful. Do these terminals in Germany that give access to a server outside Germany form a permanent establishment of Facebook in Germany under the draft of comment update? Or is this an auxiliary activity under the tax treaty? Even when employing directly 1.000 persons in a national territory? Can this be treated different then the activity of adapting production / consumer goods to national standards in a market jurisdiction?

7. Being a tax subject is not a choice but the consequence of a factual situation, so it seems irrelevant if that employee is the consequence of a court ruling or of a formally concluded labor contract. A contractor or an employee that is deemed to be employed under national labor law gives cause to a permanent establishment for tax law purposes similar to an employee that was formally contracted under national labor law by a non-resident company.

Can the comment update offer both rationale and guidelines on when and how a permanent establishment can be considered present given these various hypotheses of employees and services triggered under non-tax law throug digital activities of a non-resident enterprise?

E. SCOTUS ruling of 21 June 2018 on local sales tax, *South Dakota v. Wayfair* : e-tailers have a presence for local sales tax purposes :

8. In the SCOTUS ruling of 21 June 2018 in the case *State of South Dakota v. Wayfair*[1] it is considered that purely physical criterions of presence for granting rights to tax turnover of digital activities have become unfair between States of the United States:

- On the criterion of digital presence (p. 15 of the ruling) :

  *"But it is not clear **why a single employee** or a single warehouse should create a substantial nexus while "physical" aspects of pervasive modern technology should not. For example, a company with a website accessible in South Dakota may be said to have a physical presence in the State via the customers' computers. A website may leave cookies saved to the customers' hard drives, or customers may download the company's app onto their phones. Or a company may lease data storage that is permanently, or even occasionally, located in South Dakota. Cf. United States v. Microsoft Corp., 584 U. S.(2018) (per curiam)."*

- On considering fairness in taxing through a digital presence (p. 17 of the ruling) :

  *"But there is nothing unfair about requiring companies that avail themselves of the States' benefits to bear an equal share of the burden of tax collection. Fairness dictates quite the opposite result. Helping respondents' customers evade a lawful tax unfairly shifts to those consumers who buy from their competitors with a physical presence that satisfies Quill—even one warehouse or one salesperson—**an increased share of the taxes**. It is essential to public confidence in the tax system that the Court avoid creating inequitable exceptions. (..) In the name of federalism and free markets, Quill does harm to both. The physical presence rule it defines has limited States' ability to seek longterm prosperity and has prevented market participants **from competing on an even playing field**."*

- Conclusions (p. 18 and 22 of the ruling) :

  "*If it becomes apparent that the Court's Commerce Clause decisions prohibit the States from exercising their lawful sovereign powers in our federal system, the Court should be vigilant in correcting the error. While it can be conceded that Congress has the authority to change the physical presence rule, Congress cannot change the constitutional default rule. It is inconsistent with the Court's proper role to ask Congress to address a false constitutional premise of this Court's own creation. (..) It is currently the Court, and not Congress, that is limiting the lawful prerogatives of the States*."
  (..)
  In the absence of Quill and Bellas Hess, the first prong of the Complete Auto test simply asks whether the tax applies to an activity with a substantial nexus with the taxing State. 430 U. S., at 279. "[S]uch a nexus is established when the taxpayer [or collector] 'avails itself of the substantial privilege of carrying on business' in that jurisdiction."(Polar Tankers, Inc. v. City of Valdez, 557 U. S. 1, 11 (2009)). Here, the nexus is clearly sufficient based on both the economic and virtual contacts respondents have with the State."
  (..)

[1] https://www.supremecourt.gov/opinions/17pdf/17-494_j4el.pdf

"That said, South Dakota's tax system includes several features that appear designed to prevent discrimination against or undue burdens upon interstate commerce. First, the Act applies ***a safe harbor to those who transact only limited business*** *in South Dakota. Second, the Act ensures that* ***no obligation to remit the sales tax may be applied retroactively****. S. B. 106, § 5. Third, South Dakota is one of more than 20 States that have adopted the Streamlined Sales and Use Tax Agreement. This system standardizes taxes to reduce administrative and compliance costs: It requires a single, state level tax administration, uniform definitions of products and services, simplified tax rate structures, and other uniform rules*."

This rationale not only applies on local sales taxes (comparable to VAT or GST) but also between competing companies in any given market jurisdiction when located in different jurisdictions. Under this rationale tax treaties clearly lead to an arbitrary and outdated outcome in present times when only criterions of physical presence open the right to tax.

F. 3 CJEU 3 March 2020 rulings on corporate income taxes[2] levied on retail, advertising and telecommunication activities :

9. Hungary has levied a progressive corporate income tax on gross revenue obtained from advertising in Hungary or publicity viewed on websites in Hungary. It has also levied a similar corporate tax on retail sales in Hungary and on telecommunication activities. These taxes also apply to companies with no other presence in Hungary then these taxed digital activities.

The CJEU considered[3] that a European Member State may request specific obligations to non-resident companies to register for taxation purposes and that a no EU law opposes to determine the corporate tax base on the base of gross revenue rather than profit. The CJEU also found that both the ability-to-pay principle and the benefit principle do not object to request a higher tax rate when more revenue is collected.

These 3 rulings applied EU law, not tax treaties. Given the importance of the EU on the world level and the possibility that other countries outside the EU may be tempted to adopt similar taxes, it is recommendable that the comment update seeks to provide rationale why such corporate taxation is or is not in compliance with the UN Model Double Taxation convention.

G. Summary :

10. The various cited court rulings show a pattern of increasing incompatibility between sole physical presence criterions with the effects of control over transactions or persons in a market jurisdiction through digital activities organized from outside that market jurisdiction.

Between Member-States of the European Union, the CJEU has established the right to subject non-resident companies to corporate taxation on their revenue collected through their digital activities. Can an open conflict between similar national law and tax treaties still be avoided through an ambulatory interpretation of Article 5? This is further addressed in the input provided under question # 2.

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[2] CJEU, 3 March 2020, case C-75/18, *Vodafone Magyarország Mobil Távközlési Zrt. v. Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, ; CJEU, 3 March 2020, case C-323/18, *Tesco-Global Áruházak Zrt. v. Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, C-323/18 and CJEU, 3 March 2020, case C-482/18, *Google Ireland Limited v. Nemzeti Adó- és Vámhivatal Kiemelt Adó- és Vámigazgatósága*.

[3] CJEU, 3 March 2020, case C-482/18, *Google Ireland Limited v. Nemzeti Adó- és Vámhivatal Kiemelt Adó- és Vámigazgatósága*.

Question # 2 : How to apply the rules of interpretation under customary international law (CIL) on Article 5 ?

11. An ambulatory interpretation under Article 3(2) OECD MTC is no treaty override to the extent that the application of the national definition does not exceed the limits established by the treaty[4].

Two main features provide together a hard law base that can be applied immediately and universally as customary international law on the OECD, UN and US Models of Double Taxation Conventions:

a) The general assembly of the United Nations adopted on 20 December 2018 Resolutions No. 73/203 on Identification of customary international law and No. 73/202 on Subsequent agreements and subsequent practice in relation to the interpretation of treaties[5].

The combined effect of these two Resolutions is that rules of treaty interpretation as laid down in Articles 31 and 32 VCLT have become customary international law rules of tax treaty interpretation. It is not the articles 31 and 32 VLCT that have become a CIL rule of interpretation of treaties ; **it is the combination of the criterions laid down in these two articles that has become over time a CIL rule of interpretation**.

The following quotes out of the International Law Committee's Yearbook 2018, Chapter IV, support that finding :

- commentary on conclusion 2, §§ 2 and 3, p. 17 - 18:

  "Paragraph 1 of draft conclusion 2 emphasizes the interrelationship between articles 31 and 32, as well as the fact that these provisions, together, reflect customary international law. (..) Recourse may be had to the supplementary means of interpretation, either in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31 leaves the meaning of the treaty or its terms ambiguous or obscure or leads to a result that is manifestly absurd or unreasonable."

- and § 13, p. 22 :

  "Paragraph 5 uses the term "means of interpretation". This term captures not only the "supplementary means of interpretation", which are referred to in article 32, but also the elements mentioned in article 31 (..) The term "means" does not set apart from each other the different elements, which are mentioned in articles 31 and 32. It rather indicates that these elements each have a function in the process of interpretation, which is a "single", and at the same time a "combined", operation."

[4] C. Di Pietro, 'Tax Treaty Override and the Need for Coordination between Legal Systems: Safeguarding the Effectiveness of International Law', *World Tax Journal*, 2015, February 2015, p. 73.

[5] UN General Assembly Resolutions of 20 December 2018, # 73/203 on *Identification of customary international law* and # 73/202 on *Subsequent agreements and subsequent practice in relation to the interpretation of treaties*, to be read for full understanding of its meaning with the Report of the INTERNATIONAL LAW COMMISSION, Chapter IV Yearbook 2018,

- commentary on conclusion 2, § 1, p. 17 and § 14, p. 20:

"..First, article 31, as a whole, is the "general rule" of treaty interpretation. Second, articles 31 and 32 together list a number of "means of interpretation", which shall (article 31) or may (article 32) be taken into account in the interpretation of treaties. (..) The interpreter needs to identify the relevance of different means of interpretation in a specific case and determine their interaction with the other means of interpretation by placing a proper emphasis on the in good faith, as required by the treaty rule to be applied.(..)"

- commentary on conclusion 8, § 2, p. 64 ; § 5, p. 65 ; § 9, p. 67 :

"In the case of treaties, the question of the so-called intertemporal law has traditionally been put in terms of whether a treaty should be interpreted in the light of the circumstances and the law at the time of its conclusion ("contemporaneous" or "static" interpretation), or in the light of the circumstances and the law at the time of its application ("evolutive", "evolutionary", or "dynamic" interpretation).(..) This approach confirmed by the jurisprudence of international courts and tribunals. The various international courts and tribunals that have engaged in evolutive interpretation — albeit in varying degrees — appear to have followed a case-by-case approach in determining, through recourse to the various means of treaty interpretation that are referred to in articles 31 and 32, whether or not a treaty term should be given a meaning capable of evolving over time. (..) The interpreter thus has to answer the question of whether parties can be presumed to have intended, upon the conclusion of the treaty, to give a term used a meaning that is capable of evolving over time."

Such a type of taxation based on CIL rules of interpretation of treaties[6] would first be looking[7] at the level of activity reached by a digital business model that occurs in a national territory in order to grant the right to that jurisdiction to tax the revenue retrieved from it. Revenue itself does not trigger the right to tax, activity does when a minimum level that is considered proportionate to the size of the population in that jurisdiction is reached.

The taxation rules on revenues from only qualifying digital business models then apply regardless if it was made by resident companies, physical permanent establishment or digital permanent establishments without any physical presence in that national territory. Equal taxes levied on revenue from comparably sized digital activities are the result. Taxation is triggered when a safe harbor threshold of revenue is also passed. That threshold could also be set in function of the size of the population of that jurisdiction.

b) Article 38, paragraph 1 (b) of the Statute of the International Court of Justice that recognizes customary international law as a source of law to settle disputes between countries.

12. Under the CIL rule of interpretation, an interpretation in good faith applies on four criterions of interpretation combined: textual, historical, teleological and ambulatory, provided that the contracting parties left the meaning of that term open.

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[6] see on the origin and meaning of CIL – interpretation rules after these resolutions ; Prof. Merkouris, Panos 'The rules of interpretation of Customary International Law – Paper No. 003/2019 on Treaty interpretation and its Rules : Of Motion through Time, 'Time-Will' and 'Time-Bubbles'.', TRICI-Law Research Paper Series, University of Groningen, Faculty of law, Paper No. 8/2020 – last revisited in March 2020.

[7] for an application of these CIL-interpretation rules on Tax Treaties that relate to the digital economy : see the cañada approach suggested in the submission by Verhaeghe on November 12th 2019 to the OECD request for public input on Pillar I, and Docket No. USTR-2019-009, submission by Verhaeghe to the request for input on the French DST and further texts on the portfolio of the www.jus-tax.be website.

If that interpretation leads to an unclear, ambiguous, manifestly unreasonable or absurd finding, must be checked against :

- the presumed original will of the contracting parties (founding fathers or the historical approach),
- the purpose of the treaty (teleological approach[8]).

13. In his submission to the OECD public consultation for input on Pillar-I, Prof. Elliffe, teaching at the New-Zealand University of Auckland, reminded the concept of wealth creation that inspired nations to conclude tax treaties[9]. He finds :

> "*The four economists involved in preparing the 1923 Report discussed the four elements of economic allegiance describing them as follows:*
>
> *I. The production of wealth;*
>
> *which means all the stages involved up until the wealth comes to fruition, by which they mean "the oranges upon the trees in California are not acquired wealth until they are picked, and not even at this stage until they are packed, and not even at that stage until they are transported to the place where demand exists and until they are put where a consumer can use them."*
>
> *Under this heading, it can be seen that the production of wealth involves both the supply/residence side (manufacturing and production) and the demand/source side (transportation to the market where they are purchased and consumed). This is a more relevant category for business income.*
>
> *II. The location of the wealth;*
>
> *where the wealth is situated. Often this will be the location of the property. Relevant for passive investment income, the location of the investment capital could be in the state of source or the state of residence.*
>
> *III. The possession of wealth;*
>
> *which means, substantially, the legal framework of society and the place where property rights are enforceable. Under this heading, the right to enforce property rights can be in both the supply/residence side and the demand/source side, such as enforcing intellectual property rights or creditor/debtor obligations.*
>
> *IV. The disposition of wealth;*

[8] This rule of interpretation is favoured by the CJEU according to Gunnar Beck, 'The Macro Level: The Structural Impact of General International Law on EU Law - The Court of Justice of the EU and the Vienna Convention on the Law of Treaties.', Yearbook of European Law, Vol. 35, No. 1 (2016), pp. 484–512, in particular p. 492: '..*to favour a teleological approach are the CJEU and the European Court of Human Rights with an evolutionary approach to treaty interpretation & legal instruments as 'living instruments' whose meaning is not tied to the original and historical understanding of textual terms at the time of their conclusion nor to the subjective intention of the parties as may be deduced from the preparatory works*..'

[9] C. Elliffe, Submission on the Proposed "Unified Approach" to Pillar One, available on the OECD website on the received input

which means the stage where the wealth has reached its final owner who can consume it, reinvest it ; but in the exercise of his will to do any of these things it resides with him and his ability to pay taxes is apparent. Under this heading, residence tax is most relevant as the owner consumes or disposes of the property. It could be noted that the property could well be situated in another state.

After analysing the above four principles, the 1923 Report concludes that the stages of production "up to the point where wealth reaches fruition, may be shared in by different territorial authorities".

It is acknowledged by the OECD, that "this "origin of wealth" principle has remained a primary basis for source taxation through the many committees and draft conventions prepared under the auspices of the League of Nations".
(..)

There are at least five major areas where the source country makes a contribution to the carrying on of digitalized business in their jurisdiction:

I. the contribution to the business environment and economy:

this includes the general business confidence, corruption and law and order, affluence and ability to consume. Often goods and services purchased by a resident in the source country are then consumed either in the production of further business activities (requiring a viable fiscal environment) or in private consumption (requiring a consumer with spending power);

II. the contribution to the technological infrastructure:

this includes suitable telecommunications infrastructure, Wi-Fi and broadband, and a population with appropriate devices (computers and smartphones);

III. the contribution to the legal system:

this includes providing reliance to enforce payment for transactions, uphold intellectual property rights (such as trademarks), and maintain a competitive and conducive business environment. The protection of intellectual property rights (for example in the case of computer software) is critical to vendors of intangible products and digitalised services. The ability to deal with fraudulent and criminal behaviour is also important as are consumer protection laws;

IV. the contribution to infrastructure:

modern infrastructure to allow physical delivery of goods in a timely and protected way, provision for waste disposal for packaging materials;

V. the contribution of users to the digital business:

this may take many forms but include the role of users and social media (designing or providing content), the contribution individuals make to the network effect (family, followers and friends), the provision of assets and services as part of the sharing economy (either physically located or physically performed in the source jurisdiction), the process of review, validation and assessment (on services or goods), etc.

> *It seems clear that the benefit theory retains its credibility as a justification to tax non-residents in circumstances where the non-resident enterprise is enjoying or utilizing the type of contribution made by the source state (or by economic actors, for example, users, in the source state). This is not a modern idea but appears to have been present right from the original theoretical construct in the 1920s compromise. The concept of economic allegiance, while it is admittedly indistinct, clearly encompasses an apportionment of taxing rights between states when the activities carried on by a non-resident enterprise utilize and benefit from public services, legal, and technological infrastructure provided in the source state."*

This author also points at the 21 June 2018 ruling of the SCOTUS as applying the benefit theory that considers the use of public services and legal and technological infrastructure provided for in the source state.

14. The concept of wealth creation through digital activities in present times was further developed by the scholar S. Buriak[10], a researcher at the law faculty of the Vienna University.

In 1923, the Report of Economists identified the concept of economic allegiance as the most appropriate for resolving the problem of double taxation[11]. The underlying rationale is the economic allegiance of business profits in line with the stages of production or delivery of goods and services and income generated therefrom. In this regard, it is important to note that the PE concept is only a rule, which was built upon the deeper principles of profit allocation developed by the League of Nations and international tax practice in the early twentieth century.

A nexus should consider specific business activities with customers that directly lead to income generation and not the hypothetical intrinsic value of customers. Value creation can be relied upon when allocating profits between different units of the group to examine on a case-by-case basis what are a company's most valuable activities in terms of generating revenues. While profit allocation rules can still consider the concept of value creation in order to determine the most valuable activities in the group that should be remunerated with higher profits, wealth production should be the core concept to identify which jurisdictions should have taxing rights over business profits. Hence, there is no common value creation recipe for every business – and not even for every business model – to decide how much value is created by customers or any other value drivers and even more to apply a fixed ratio of income attributable to customers as a factor of income generation as proposed by the Unified Approach (Amount A).

Furthermore, there is no precise science on the hierarchy of the values of functions and resources and therefore, the analysis is often a matter of subjective discretion. Consequently, value creation cannot be used as the principal justification for the allocation of taxing rights to market jurisdictions[12].

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[10] Svitlana Buriak, 'A New Taxing Right for the Market Jurisdiction: Where Are the Limits?', *INTERTAX*, Volume 48, Issue 3, p. 301 – 316.

[11] Svitlana Buriak, *l.c.*, p. 306, footnote 39 : League of Nations and Financial Commission, Report on Double Taxation: Document E.F.S.73. F.19 (5 Apr. 1923) (League of Nations 1923 Report on Double Taxation). See also OECD, Action 1 Report, supra n. 34, s. 2.3.2.1; Jean Schaffner, The Territorial Link as a Condition to Create a Permanent Establishment, 41(12) Intertax 638, 645 (2013).

[12] Svitlana Buriak, *l.c.*, p. 305.

She suggests the following digital business-models that can provide a rationale to place wealth creation through digital activities in market jurisdictions :

a) Business to Business to Consumer (B2B-2C) Model: a company operating the platform and business users that are retailers or service providers.

Such platform can collect end-consumer data to provide additional services like targeted advertisements of business users' products leading to an additional stream of revenue for the platform operating company and to added value for the services of the business users. In that regard, the data collected is an input into the wealth production process of delivery of targeted advertisement services.

Therefore, it is considered that the market jurisdiction where the end-consumers – being a source of income-generating data – are located should also be regarded as the place of origin of income since the main input in the wealth production process is extracted there.

b) Business to Consumer to Business (B2C-2B) Model : a company providing free services to build a base of potential consumers for business users, being the ultimate targeted customers of the platform.

The role of the end-users of the platform is to give consent to the collection of their personal data to be used in the marketing activities or sales in exchange for services received by the platform. Therefore, data collection (extraction) should be considered as a business function of the platform rather than a user contribution. Nevertheless, end-user data is a meaningful input into the wealth production process of social media networking and search engine businesses. Data is a product in itself.

The data collection activity from the market jurisdiction being one of the main activities of the company in the wealth production process should lead to the taxing rights being allocated to the market state since in that case, customer data is one of the primary sources of wealth for such companies. Therefore, for social-media platforms, a nexus should be established to the jurisdiction where the end-users are located and from where data is extracted.

c) Digital Media Platforms: a company uses personal preferences of the customers to offer personalized choices to the customers.

The targeted advertisements are primarily based only on limited[13] personal information like gender, age, and location of the end-users. Therefore, the role of end-users in the wealth creation process of digital media platforms is present.

d) Business to Customers (B2C) E-Commerce Model : the question in Madam Buriak's view is whether companies merely selling their products in other jurisdictions through websites and applications should be within the scope of a new taxing right of the market states if the new right is based on the principle of origin of income and not on the destination-based approach.

[13] The author of this note finds that all personal information is considered relevant for marketing purposes. Even the location.

The author of this note has another view on the E-Commerce Model then Madam Buriak with regard to the criterion of wealth creation. Web shops can also use information of users to incite them to buy the goods bought by the company running it, rather than those of the goods of other competing companies that are also put up for sale in that web shop. Web shops of companies that produce their own goods or services will typically mainly or only present that group's products on their websites. Customers have a role of wealth creation in web shops that mainly offer goods produced by other groups.

Madam Buriak considered that the destination-based cash flow tax is grounded on merely practical aspects of the prevention of tax avoidance and the race to the bottom imposed by tax competition in the long run. Other considerations justifying destination-based taxation are that the customer-based intangibles are located in the jurisdiction of the final purchaser and that the benefit principle may at least to some extent justify the allocation of taxing rights on a destination basis[14].

However, there is no need for interpretation rules of treaties for the vast majority of groups that produce services and goods. These groups typically have, if not resident subsidiaries, at least an PE through an agent that is to follow up on customers' requests in territories with enough customers.

Companies that just sell goods or services over the internet they did not produce are eligible to qualify for this model since they present a risk for tax avoidance by not having a physical presence in that jurisdiction. This rejoins the first motivation for destination-based taxation: addressing and preventing tax avoidance.

Also, what is the rationale to consider that goods and services from various companies sold on platforms qualify and goods and services from various companies sold on websites do not? The type of digital medium seems irrelevant when not producing the sold products.

Finally, destination-based taxation as a tool to address tax avoidance is justified in the presence of groups that produce 'tools of connectivity' such as laptops, smartphones, tablets, etc. These products typically have a large portion of their price to cover Intellectual Property Rights that can be shifted at leisure over the globe by that group. So, groups that sell tools of connectivity they produce should also be included in this business model.

15. This rationale under CIL rules of interpretation of Article 5, when applied on business models that create wealth through their digital activity in the market jurisdiction that requires user activity, lead to the following findings :

[14] Svitlana Buriak, *l.c.*, p. 302, § 6 with reference to B. Moreno, A Note on Some Radical Alternatives to the Existing International Corporate Tax and Their Implications for the Digital(ized) Economy, 46(6/7), *Intertax* 560, 561 (2018); M. Devereux, Pillar One: First Step Towards a Destination-Based Tax?, 1461 *Tax J.* (16 Oct. 2019), https://www.taxjournal.com/articles/pillar-one-first-step-towards-a-destination-based-tax (accessed 28 Jan. 2020). See also B. Rajathurai & M. Clayson, Unify and Conquer: The OECD's 'Unified Approach' to Pillar One, 1461 *Tax J.* (16 Oct. 2019), https://www.taxjournal.com/articles/unify-and-conquer-the-oecd-s-unified-approach-topillar-one (accessed 28 Jan. 2020); J. Li, Global Profit Split: An Evolutionary Approach to International Income Allocation, 50(3) *Can. Tax J.* 823, 866 (2002); M. F. de Wilde, Comparing Tax Policy Responses for the Digitalizing Economy: Fold or All-in, 46(6/7) *Intertax* 466, 473 (2018).

A. "Business" relates also to business conducted through 'digital activities':

1. Textual method:

An economic activity subject to risks that takes partially or entirely place in the market jurisdiction also includes digital economic activity.

2. Historical method:

In 1923 a compromise was found around 'economic allegiance' to grant the right to tax : see the rationale cited from the contribution of Prof. Eliffe to the public consultation on Pillar I and the article of Madame Buriak for applying this on business models with digital activity.

3. Teleological method:

The OECD has inserted the following purpose of tax treaties into the OECD Model Double Taxation Convention, version 2017, under points 11.2 and 15.6:

> *"11.2 Since the publication of the first ambulatory version in 1992, the Model Convention was updated 10 times (in 1994, 1995, 1997, 2000, 2002, 2008, 2010, 2014 and 2017). The last such update, which was adopted in 2017, included a large number of changes resulting from the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project and, in particular, from the final reports on Actions 2, 6, 7 and 14 produced as part of that project (..)*
>
> *15.6 An important objective of tax treaties being the prevention of tax avoidance and evasion, (..)"*

Since 2017, prevention of tax avoidance and evasion is a recognized purpose of tax treaties for the OECD. Similar objectives can be noted in the UN Model Double Taxation Convention of 2017, under points 6, 6.1 and 17.4:

> *"6. Broadly, the general objectives of bilateral tax treaties therefore include (..) They also aim to prevent certain types of discrimination as between foreign investors and local taxpayers, and to provide a reasonable element of legal and fiscal certainty as a framework within which international operations can confidently be carried on. (..) In addition, the treaties seek to improve cooperation (..) with a view to preventing avoidance or evasion of taxes and by assistance in the collection of taxes.*
>
> *6.1 Finally, it has become clear as a result of international focus on base erosion and profit shifting that treaties are not intended to facilitate treaty shopping and other treaty abuses.*
>
> *17.3 In particular, the Committee noted that the Manual provides the following useful checklist of the benefits and costs commonly associated with tax treaties :*
>
> - *Avoidance of fiscal evasion."*

The 2017 UN Model Double Taxation convention also cites point 15.6 of the OECD Model Double Taxation Convention.

Digital activities are particularly risk-full from a BEPS perspective; by eluding a permanent establishment various BEPS measures cannot be activated. In their paper published on 22 October 2019 on the website of CEPS[15], L. Carpentieri, S. Miscossi and P. Parasancdolo invite their readers to further reflections on new corporate income taxes needed for the digital and immaterial economy.

Traditional profit determination has become inapt to capture the goal of taxing 'return to capital'. Intangible assets are very difficult to allocate and determine. Something has value in a digital age when used and for as long as it is used. Although one can determine how much the model is used, nobody knows how long that digital business (line) model will endure, making yearly depreciation often meaningless.

Internet and digital platforms have created an 'above territories' territory, inaccessible to national tax authorities, allowing such stateless income not to contribute to public expenditure in the countries where multinational companies sell their goods and services.

So, an ambulatory interpretation of Article 5, paragraph 1, that consider 'business' as including 'digital activities' in order to better address the risks of tax avoidance through digital activities is in line with the purpose of tax treaties.

4. *Ambulatory method:*

The term 'business' was not defined. It's meaning can so evolve as including in present times digitally conducted economic activity.

5. *Good faith test:*

This combined interpretation of these four methods is in line with good faith.

6. *Unclear, ambiguous, manifestly unreasonable or absurd test:*

This combined interpretation that includes digital activities does not lead to a meaning of 'business' that is unclear, ambiguous, manifestly unreasonable or absurd.

B. "fixed place" for business conducted through 'digital activities':

16. Once established that under CIL rules of interpretation business also includes digital business activities, it must be determined when and where a 'fixe place' opens up the right to tax the digital activity for a market jurisdiction.

These terms are also not explicitly defined in tax treaties[16] so they can in turn be subject to the CIL rules of interpretation of treaties.

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[15] L. Carpentieri, S. Miscossi and P. Parasancdolo, *Overhauling corporate taxation in the digital economy*, paper published on CEPS website October 22nd 2019 link: https://www.ceps.eu/ceps-publications/overhauling-corporate-taxation-in-the-digital-economy/

[16] GARBARINO, C. Judicial Interpretation of tax treaties: The Use of the OECD Commentary. Cheltenham UK : Edward Elgar Publishing, 2016, p. 21 (I.63), zie ook inzake het OESO – modelverdrag (versie 2014) : Commentary on Art. 5 (1) § 5.1-5.4. : een zone die kan worden omschreven binnen dewelke de activiteiten plaatsvinden die als een commercieel en geografisch coherent geheel kunnen worden aanzien.

1. *Textual method:*

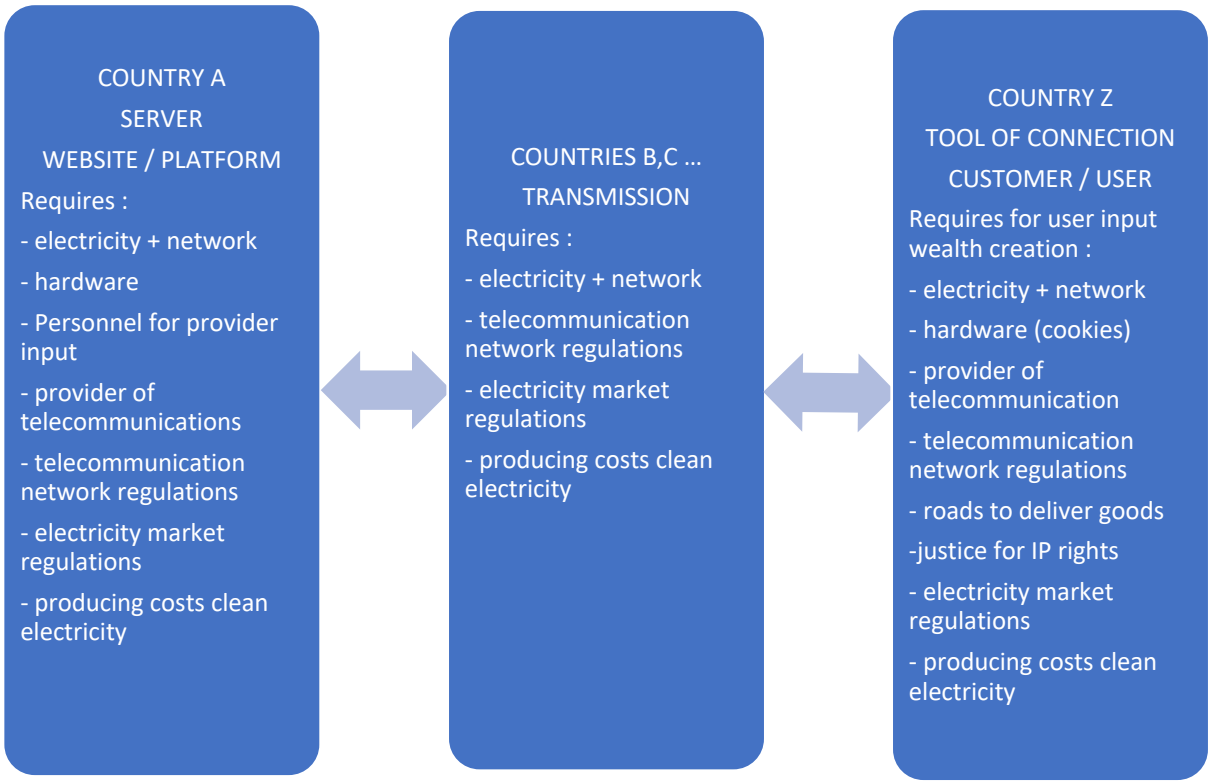
17. What is a ‘place’ for a digital activity and when does it become ‘fixed’?

In the USA, OECD and UN Model Double Taxation Convention Article 5 has a generic part in paragraph 1. The other paragraphs sum a list of criterions of physical presence that are not intended to be exclusive. Soo types of business that not fall under one of these listed criterions of presence may fall under the generic definition of paragraph 1.

The word ‘place’ relates to a geographically specific location that offers a facility from where business can be conducted (see # 3 of the draft of comment update) and ‘fixed’ basically relates to the frequency of use of that geographically specific location (see # 36 of the draft of comment update).

A digital activity takes place on both the servers of websites and the tools of connectivity of the user (computers, tablets, televisions, phones, smart watches...) and of the company that runs the server. On both the moments of active connection (user activity) and passive connection (cookie activity) it is a whole that creates wealth through digital activities in the market jurisdiction :

Digital activities production cost for wealth creation:



18. This intertwined process is also considered in international tax doctrine as a process of 'prosumption' : a part of the digital activity is produced on the users side[17]. That production part of the consumer also creates wealth in that approach. Madam Buriak provided another approach to determine wealth creation that allows to scale the part of wealth creation through users in the production process of digital activities. Different levels of wealth creation can be established according to the identified business models.

Simply put : a server without users creates no wealth.

In the source jurisdiction, the right to tax the part of wealth that is created there is triggered by the presence of the server (similar result as # 79 & 80 of the draft of comment update).

In the in-between jurisdictions, there is no wealth creation that can trigger the right to tax (similar result as # 36 of the draft of comment update).

In the market jurisdiction, next to the non-resident company, the user also has need of the telecommunication service provided for by a cable and regulated telecommunication companies (see # 36 of the draft of comment update). The notion of prosumption singles out digital activities from other economic activities; their production process requires the use of destination-based facilities and user-input.

19. Soo the right to tax the part of wealth that is created can be triggered when digital activity occurs on the tools of connectivity located in that jurisdiction. A 'geographical specific location' that is in a coherent whole with an economy activity that has use of digital activity considers :

- Domicile address of registered users.
- Activation location of the tool of connectivity for unregistered / foreign users when present in that jurisdiction.
- Location of where a contract that was concluded through digital activities or must be executed through digital activities.

One could think here of criterions of frequency as set out by the Supreme Court of the United States in the Way-fair ruling[18] : 200 contracts per 1.000.000 population. The State of South-Dakota approximately has 1 million inhabitants and a minimal activity involving 200 contracts that was considered relevant as opening up the right to tax the gross receipts. A safe harbor required a minimum threshold of 100.000 USD gross receipts for taxation purposes.

One could also think at criterions for a significant economical presence as set out by the

[17] Prof. HOYOS, Catalina (2019). *La tributación en medio de la revolución digital*. Ponencia para las 43 Jornadas Colombianas de Derecho Tributario, Instituto Colombiano de Derecho Tributario (ICDT), Cartagena de Indias, Colombia, 2019), with references to: On the notion of digital permanent establishments (notes 245 and 246: Brauner, Yariv y Pistone, Pasquale (2017), 'Adapting current international taxation to new business models; two proposals for the European Union.', *Bulletin for international taxation*, December 2017, IBFD journals and Brauner, Yariv, Pistone, Pasquale (2018), 'Some comments on the Attribution of Profits to the Digital Permanent Establishment', *Bulletin for International taxation*, Journals IBFD ED 74 (4a); on the need to find other criteria of taxation such as connection (notes n° 123 and n° 243: Vanistendael, F., "Digital Disruption in International Taxation", TNI, 8 January 2018 and Valente, Piergirogio, 'Digital revolution. Tax revolution?', *Bulletin for international taxation*, 2018 (volume 72), n° 4); or on the difficulties related to taxing digital bartering (note n° 138: Tardivon-Lorizon, E & A.Z Quenette (2018) *Indirect taxation of E-Commerce – Significant Recent Changes in the United States and the European Union*, 29 intl. VAT Monitor 6, journal IBFD).

[18] SCOTUS, 21 June 2018, *State of South Dakota v. Wayfair*, https://www.supremecourt.gov/opinions/17pdf/17-494_j4el.pdf

European Commission in the draft of proposal for a directive in March 2018[19]. The European Commission proposed criteria for a digital permanent establishment of 100,000 USERS, CONNECTIONS as a tool to allocate income and 3,000 commercial CONTRACTS linked to providing digital activities to other enterprises. That proposal is in the view of the author of the note not relevant for CONNECTIONS since it is expressed as a threshold of income and not a minimum of use of tools of connectivity in that market jurisdiction.

Smaller Member States of the European Union questioned these criteria, since, for lack of sufficient population, they would have none to very few enterprises on their national territory that could meet these sizes of activity. The same concern applies worldwide for smaller countries when determining criteria for activity. The author of the note proposes a scale of a million USERS for countries with a population of at least 20 million inhabitants. Per million of population, 5,000 users could be a criterion for USERS.

Both business-related (customers) and private (consumer) connections may qualify for an activity that is sufficiently frequent. But small nations with a lot of business may create far more connections. A relevant criterion for frequent activity is the yearly access rate of users, set at a minimum of one connection per week per user (50 weeks x USER criterion).

This leads to the following level of digital activity :

Criterion/inhabitants	**SCOTUS** **scale 1 million**	**EC** **large Member State =** **+ 20 million inhabitants**	**cañada approach** **scale 1 million**
USERS		100,000 / 20 = 5,000 per million	5,000
CONNECTIONS			250,000
CONTRACTS	200 / million		200
SAFE HARBOUR	100,000 USD / million		+ 100,000 USD

These proposed sizes are motivated by SCOTUS case-law and proposals of the European Commission.

20. These locations are relevant for the production process or the wealth creation which takes in part place in the market jurisdiction. However, the draft of comment for update clearly indicates that it is required that a place must be at the *disposal* of the non-resident company, be it even for short periods of time.

It is that requirement of being at the disposal of the non-resident company that opposes, according to the draft of comment update, to qualify the use of cables or other devices of telecommunication as a place of business for digital activities (see # 36).

[19] European Commission, Proposal for a COUNCIL DIRECTIVE laying down rules relating to the corporate taxation of a significant digital presence, SWD(2018) 82 final (https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_significant_digital_presence_21032018_en.pdf) ; COMMISSION RECOMMENDATION of 21.3.2018 relating to the corporate taxation of a significant digital presence, C(2018) 1650 final

Under that interpretation, only conducted business through digital activities that require the disposal of specific location in the market jurisdiction that can trigger a permanent digital establishment. Provided that that digital activity occurs frequently enough to be considered a constant or quasi-constant form of business.

2. *Historical method:*

21. As Professor Elliffe pointed out ; it was the various forms of wealth creation that existed through physical presence in 1923 that lead the contracting parties to define a set of exemplative but not exclusive physical criteria next to the generic requirement of conducting the business entirely or partially in the market jurisdiction.

Under that leading criterion of wealth creation, digital activities fit in under Article 5 in order to open the right to tax, as pointed out by both Professor Elliffe and Madame Buriak.

3. *Teleological method:*

22. As established above, the present purpose of tax treaties is also to address tax avoidance through BEPS. In order to allow countries to use an entire set of instruments against BEPS under the tax treaties, a permanent establishment is required. Set aside from what can be taxed, a permanent establishment for digital activities allows in the first place to address various forms of intra-group profit or revenue (base erosion) shifting through digital activities.

The purpose of tax treaties is also to submit companies to taxation without discrimination; companies that reach important levels of digital activities in the market jurisdiction can be required to pay a minimum level of tax as their resident competitors are required to pay.

Finally, the goal of tax treaties is to tax where wealth is created. For these three purposes, digital activities can in good faith trigger the non-resident company to become a tax subject when the business models in which they occur present high risks of eluding taxation and by doing so disturb fairness in competition and contributing to the public finance of various services provided for in the market jurisdictions. The author of the note has identified various type of business models that use digital activities with user activity that fall in scope under these various purposes of tax treaties[20].

4. *Ambulatory method:*

23. No explicit definition was given to the notion of a 'fixed place' ; it can evolve over time to adapt to present times were the tax treaty must be applied.

5. *Good faith test:*

24. This interpretation seems in line with good faith. As a result of the four methods, it is the requirement under the 'textual method' that conflicts with the other 3 methods. This through

[20] submission by Verhaeghe on November 12th 2019 to the OECD request for public input on Pillar I, the business models in scope under that criterion of risks for BEPS are similar to the ones identified par Madame Buriak under the criterion of wealth creation and those selected in the working documents of the European Commission in March 2018 (see prior note), also to be found on the www.jus-tax.be website.

the requirement of a specific location at the disposal of the non-resident company that is frequently used.

6. Unclear, ambiguous, manifestly unreasonable or absurd test:

25. None of the four methods gives cause to an unclear or an ambiguous outcome. However, the textual method leads to a manifestly unreasonable or absurd situation in present times that conflicts with both the purpose of tax treaties and the historical intent of the contracting parties.

Under the SCOTUS ruling of 21 June 2018 in the case *State of South Dakota v. Wayfair*[21], the sole criterion of physical forms of presence is clearly marked as outdated in economies where major parts are made up be digitally conducted business. It gives cause to distortion of both competition and tax fairness.

The CIL rules of interpretation require then to address in the interpretation of the tax treaty that situation, by considering in good faith the original intention of the contracting parties and the present purpose of tax treaties in the context in which they must be applied. As pointed out, both the original intention of the contracting parties and the present purpose of tax treaties in the context in which they must be applied allows in good faith to tax digital activities occurring in the market jurisdiction.

26. The conflict resides in the requirement of the disposal of a specific location in the market jurisdiction. The main argument than can invoked in defense of that criterion is that it serves legal certainty on the main question of becoming a tax subject or not.

On the other hand, when using the size of digital activity through tools connectivity located in the market jurisdiction, legal certainty is also offered on the question of becoming a tax subject or not.

27. The fundamental question raised by that debate relates in the view of the author of the note back to the sovereign right to tax digital activities occurring in the market jurisdiction that have no need of a specific location in the market jurisdiction from where to organize or conduct the digital activities.

Digital activities cannot be conducted without the activation of tools of connectivity of users located at that time of activation in a given territory. In order for the digital service to take place, that user must pay for telecommunication services, electricity used, etc.

That electricity is generally produced in that territory and must be transported to the location where it feeds the tools of connectivity of the user (portable phones, tablets, computers, television) and the telecommunication network. The production and sale of that electricity is monitored, regulated and taxed by the authorities in most jurisdictions. Urgent carbon free production of electricity under climate policies need major public investments and incentives for private investments in the coming years.

[21] SCOTUS, 21 June 2018, *State of South Dakota v. Wayfair*, https://www.supremecourt.gov/opinions/17pdf/17-494_j4el.pdf

The telecommunication networks need to be constructed, maintained, upgraded and fed with electricity. Telecommunication operators are regulated by national authorities and law.

The company that has control over the server is the only one that gets revenue out of the activation of the digital service. It can provide the digital service through this chain of factors (telecommunication network, electricity network,..) located in the place where the user activates that digital service. That chain is entirely national when the residence of both contracting parties is located in the same country and revenue is also collected there. It becomes an issue when there is no common residence or collection of the price in the same country ; since then it is possible to escape a minimal contribution to these costs.

It suffices to open the right to tax to observe that no digital activity could have taken place without these services and facilities provided for in the market jurisdictions by investments or regulations of their governments.

28. Such tax is not extraterritorial. Stating the opposite is in violation with the Westphalian doctrine that applies in international law since 1648. Prof. Greggi, teaching at the Italian university of Ferrara, reminds this fundamental doctrine when discussing digital taxation[22]. Activities occurring on a nation's territory open the right to tax it by its sovereign: within its territory, the state is free to set taxation in accordance with what it considers being more consistent with its priorities, its political decisions and, eventually, its necessities[23].

Prof. Greggi finds that *value creation* cannot be calculated by specific online services and the competitive advantage granted to them by the principle of the Net neutrality, unless linked through prosumption to user activity in that territory[24]. He finds[25] on the other hand that once a sufficient level of sales occurs, there is an exploitation of the service and/or legal network in that territory. With remote digital sales occurs a free riding of the infrastructure that is needed, the education of people required to access the internet, …

29. In substance, the earlier cited landmark ruling of 21 June 2018 of the SCOTUS in the Wayfair case did acknowledge that even remote sales have use of public services in the destination State and that this finding opens the right to tax. In that, this ruling is in full alignment with the Westphalian doctrine when overriding its earlier requirements on physical presence in order to tax[26].

It is irrelevant for the Westphalian doctrine what shape and size the activity that *creates wealth* takes, as long as it can be in part located in the territory of that sovereign state by having need of services provided for by that sovereign. The criterions of international taxation of the base of residence, source or even citizenship all relate back to the sovereign territory.

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[22] Marco Greggi, 'Rise and Decline of the Westphalian Principle in Taxation: The Web Tax Case.', *EC Tax Review*, 2020/1, p. 6 – 21.

[23] M. Greggi, *l.c.*, p. 6, footnote 10 : A. H. Qureshi, The Freedom of a State to Legislate in Fiscal Matters Under General International Law, Bull. International Fiscal Documentation 16 (1987).

[24] M. Greggi, *l.c.*, p. 10, with reference to footnote 37 : In Italy, e.g. a very successful American provider of online videos and films is successfully competing with an equivalent service granted by the local Telecom company that is the owner of the network used by the former one for free. Without the net neutrality principle, the second company would make the access to the market by the first one more expensive thus recapturing a margin of competitiveness that is currently lost. For this reason, it is, at best, very difficult to assess the actual creation of value of one company in a State as the pricing strategy for services or delivered goods does not consider the impact of Internet free riding by the digital companies (and it never did). And p. 19 on prosumption.

[25] M. Greggi, l.c., p. 16

[26] The cited author Greggi sees this ruling as in conflict with the Westphalian doctrine. The participant has another view.

It is the Tax Treaties that have become, through evolving technology, outdated and in their non-evolutionary interpretation inconsistent with the Westphalian doctrine. Hence, the suggestion to the Commission to consider the CIL rules of interpretation as found by the INTERNATIONAL LAW COMMISSION and acknowledged by the resolutions adopted by the General Assembly of the United Nations on 20 December 2018.

30. It suffices to interpret a 'fixed place' as relating in present times to a coherent whole commercially and geographically under the generic definition in paragraph 1 of Article 5. Such coherent whole is met through requirements of certain levels of digital activity in the market jurisdiction, set in function of its population. That digital activity must create (additional) wealth through users and be frequently enough activated by them in order to form a constant or quasi-constant form of activity that creates wealth in that jurisdiction.

This interpretation of a 'fixe place of business' as a coherent whole commercially and geographically is considered in the draft of comment update by the Commission :

> # 22 => a single place of business will generally be considered to exist where, **in light of the nature of the business**, a particular location within the activities are moved may be identified **as constituting a coherent whole commercially and geographically with respect to that business**

That comment basically follows the more extensive OECD comments on Article 5 in the OECD Model Double Taxation Convention of 2017 [27] :

> *"As recognized in paragraphs 51 and 57 below a single place of business will generally be considered to exist where, in light of the nature of the business, a particular location within which the activities are moved may be identified as constituting a coherent whole commercially and geographically with respect to that business[28].*
> *(..)*
> *29. One exception to this general practice has been where the activities were of a recurrent nature, in such cases, each period of time during which the place is used needs to be considered in combination with the number of times during which that place is used (which may extend over a number of years).*
> *(..)*
> *34. Where a place of business which was, at the outset, designed to be used for such a sort period of time would not have constituted a permanent establishment but is in fact maintained for such a period that it can no longer be considered as a temporary one, it becomes a fixed place of business and thus – retrospectively – a permanent establishment.*
> *(..)*
> *35. For a place of business to constitute a permanent establishment the enterprise using it must carry on its business wholly or partly through it. As stated in paragraph 3 above, the activity need not be of a productive character. Furthermore, the activity need not be permanent in the sense that there is no interruption of operation, but operations must be carried on a regular basis."*

[27] Model Tax Convention on Income and on Capital 2017 (Full Version), Commentary on Article 5, p. 300, # 22 & p. 302, # 29, p. 303-304, # 34 & # 35,

[28] Paragraph 51 also cites the criterion for a contractor that work on a building site : the entire site is a coherent whole commercialy and geographically (comment under Article 5, § 3). Paragraph 57 relates to building sites.

The nature of business is recognized in these comments of the OECD as relevant to consider a particular location. As is the frequency of use.

31. When considering business models that have use of digital activity of their users to create (additional) wealth, the production of wealth takes place on the activated tools of connectivity of the users.

The nature of business conducted through digital activities therefor dictates that all activated tools of connectivity of users, be it active (user) or passive (cookies) are spots where digital activity occurs that form a coherent whole commercially and geographically. These digital activities are in turn channeled in both directions (server – tool of connectivity) through the cables of telecommunication providers to the website outside the market jurisdiction. The whole is one single production process of wealth that takes in part place in the market jurisdiction.

Thus, tools of connectivity are parts of equipment involved in such a production of wealth. When considering that for physical activities the mere disposal of premises where no production occurs may justify a permanent establishment, it becomes clear that the requirement of a physical location in which the activities are moved can in present no longer be used as a requirement for such digital activities.

For that atypical form of wealth creation, it is paramount to limit the scope of this interpretation of a 'fixed place' to business models that create wealth through digital activities by their users. A minimal level of digital activity must be met in order to become 'fixed' and provided that this economic activity is not not already captured under a physical presence criterion of the other paragraphs of Article 5.

This interpretation of 'a fixe place of business' for such digital activities is compliant with CIL rules of interpretation of treaties.

C. That CIL interpretation of a "fixed place of business" for digital activities provides better legal and tax certainty:

32. This interpretation of 'fixed place of business' for digital activities requires :

- digital activities that are used in business models to create (additional) wealth through users (data, costs borne by them),
- and that are frequently enough activated in the market jurisdiction to constitute a coherent whole commercially and geographically.

This interpretation:

- Upholds CIL rules of interpretation of treaties when applied on Article 5, § 1 of the OECD, UN and US Model Double Tax Conventions for determining nexus criterions for a permanent digital establishment.

- Provides better legal and tax certainty to both the tax payers and the tax administrations through clear nexus criterions and boosts equal treatment.

  The use of cables or telecommunication services cannot trigger in itself a permanent digital establishment. Only sufficient activations on tools of connectivity or contracts in the territory that cable passes through may trigger a nexus.

  The problem of increased legal uncertainty posed by recent rulings that qualify services provided by independent contractors as either employees, agents or services of the non-resident company may so be reduced as to the tax uncertainty they cause :

  a) In these cases, a permanent establishment may be subsequently triggered under paragraph 1, 5 or 9 of the UN Model Double Tax Convention (see question # 1) that opens up the right to activate BEPS measures.

     The CIL interpretation of paragraph 1 of Article 5 does not impact permanent establishments that are present under the other paragraphs.

  b) But the CIL interpretation can provide an exemption for taxation purposes that could be granted under Article 7.

     When not reaching the minimum level of digital activity as required under Article 5 to constitute a permanent digital establishment, no corporate taxation is triggered. But BEPS measures can still apply.

     This exemption would size down the consequences of a trade law or a labor law litigation before national judges for back-firing taxation issues (boosts tax certainty) and enhance a level playing field were all enterprises involved in digital activities are treated equally by only becoming subject to corporate taxes when meeting a minimal activity and income.

- Provides an answer to distortion of competition by eluding normal labor conditions, participation to the costs of public services (benefit principle) and tax fairness (ability-to-pay principle), allowing governments to bring these digital activities within scope of BEPS measures in order to address abusive use of rights granted under the tax treaty.

33. By considering the extent of additional wealth that can be created by business models that have use of activation of the tools of connectivity of their users, be it active or passive (cookies), a rationale is provided to the subsequent question under Article 7 on how to tax the digital activities that give cause for a permanent digital establishment.

The author of the note has exposed the rationale to that end in his submission to the OECD public consultation on Pillar I[29] and suggests that 50 % of the gross receipts always goes to the

[29] submission by Verhaeghe on November 12th 2019 to the OECD request for public input on Pillar I, also to be found on the www.jus-tax.be website.

jurisdiction that has supported the tax deduction of the premises, servers, programmers etc.. and an additional 25 % as a minimal tax base for that 'source jurisdiction'.

The remaining 25 % of the gross receipts obtained worldwide from the digital activities in that marketing jurisdictions can be taxed by that market jurisdiction through a mix of 5 factors :

- the risk of avoiding tax costs (T),
- the high profit margin for that type of business (P),
- the value of user input in production (U),
- avoiding payment for costs generated such as provoking high use of electricity by users in the market jurisdiction (C),
- location savings that refer to the ability to set prices targeting resident competitors and thus causing job losses or the ability to substitute workers by independent contractors (S).

type of digital activity	**Criterion (expected highest yield for tax base)**	**margin**
Paid services for information or communication of standardised data.	USERS / CONTRACTS	10 % T & C
Free of charge users or free services.	CONNECTIONS / USERS	15 % T & U & P
Sale of goods that include substantial intellectual property rights in the price than can be used as connection tools.	CONTRACTS	15% T & P & C
Online sale of goods that are not produced by the seller.	CONTRACTS	20 % T & U & P & S
Paying services for personalised data or services / web-payments / traders / token-platforms.. (except professions that cannot legally sell their clients' data to third parties and must generally meet clients in person).	ALL THREE CRITERIA	25 % T & U & P & C & S

CLOSING REMARKS

34. The author of the note thanks you for reading through this note and is at the disposal of the Committee if further input would be required. The author will not provide input on the draft of comment update on Article 7, except for the general observation that profit is no basis that can lead to a fair and effective taxation of wealth created through digital activities. Only turnover (gross receipts) over a tax base that may prove effective and fair.

In his submission to the public consultation of the OECD on pillar I of the Unified Approach, he labeled the CIL interpretation of tax treaties as an alternative while awaiting an international consensus on tax treaty-change the cañada approach. This cañada approach is in line with finding a system that can be implemented by the tax administration of developing countries :

> "*The United Nations Committee of Experts on International Cooperation in Tax Matters formed a Subcommittee on Tax Challenges Related to the Digitalisation of the Economy. That Subcommittee presented a report on 18 April 2019 on Tax Issues related to the Digitalisation of the Economy*[30]*. The mission of that Subcommittee is to identify those issues and to present solutions that take into account the following objectives:*
>
> - *avoiding both double taxation and non-taxation,*
> - *preferring taxation of income on a net basis where practicable and,*
> - *seeking simplicity and administrability.*
>
> *Following that report, the current issue at stake is the need to adapt tax treaties on nexus and profit allocation to the emergence of digital activities*.
> *(..)*
> *The method of profit attribution under SEP methods is defined by the Subcommittee (§ 15) as considering 'both production and sales as essential for generation of profits, and that neither can be ignored for the purpose of determining the profits that would be taxable in a jurisdiction' and indicates that for developing countries this approach is the simplest and allows using withholding taxes for efficiency purposes.*
>
> *The Subcommittee further points at the use of the fractional appointment method of profits in this approach. The fractional appointment method is an existing method for profit attribution if no books or accounts are kept by the permanent establishment. This would typically be the case for a digital permanent establishment.*
>
> *According to the Subcommittee a formulary apportionment would require:*
>
> *(a) definition of the tax base to be divided;*
> *(b) determination of the factors on the basis of which that tax base is to be divided and;*
> *(c) the weight of these factors."*

The cañada approach complies with these objectives by providing a legal hard law base with rationale for a nexus and a formulary apportionment that is simple and has use of clear criterions. The tax base can be used for withholding taxes, corporate taxes and indirect taxes on digital activities (on other rationale and criterions than digital service taxes).

[30] https://www.un.org/esa/ffd/wp-content/uploads/2019/04/18STM_CRP12-Work-on-taxation-issues-digitalization.pdf

35. The suggested approach also addresses effectively the recent problems posed by requalification of business activities under national non-tax law of jurisdictions, gives no cause to extraterritoriality, reduces tax uncertainty and boosts equal treatment between all competing enterprises in a jurisdiction and effective tax collection on wealth created in that jurisdiction.

As expressed in his submission of July 2019 on French Digital Service Taxes and of June 2020 on various other Digital Service Taxes to the USTR[31], the author of this note hopes that these findings under tax treaty – interpretation may help to restore tax certainty, tax fairness and avert a trade war in 2021 if no solution is found by the end 2020 on treaty-change by the OECD.

Brussels, August 9th 2020,

Paul Verhaeghe

[31] Also available on the www.jus-tax.be website or on the USTR Docket No. USTR–2019–0009 and No. USTR–2020–0022