Chapter 22: *Fowler v. Commissioners for Her Majesty's Revenue and Customs*: Some Thoughts on Tax Treaty Interpretation

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22.1. Article 3(2) OECD Model Convention

David Rosenbloom is one of the giants of international tax law. He is also a cosmopolitan and a recognized expert on all continents. Moreover, he is often asked by courts in different countries to provide his expert opinion. He makes himself available to deliver lectures at various universities, and I have never heard about him rejecting an invitation to do so. At New York University, it was his great commitment that made the LLM Program in International Tax Law such a success. He personally attends to the needs of each of his students, and it is impressive to experience how he can immediately recognize former students after several years and know so many details about their careers. I myself have repeatedly had the honor and pleasure to teach at NYU. In addition to European tax law, I also delivered lectures on the OECD Model Convention, together with David. For this reason, I would like my contribution to his *Festschrift* to deal with a central provision of this Model Convention, article 3(2), which addresses its interpretation. On 20 May 2020, the UK Supreme Court took a position with regard to individual aspects of this rule.[2] I would like to take this as an opportunity to take a closer look at this judgment.

The judgment relates to the DTC between the United Kingdom and South Africa. The version of article 3(2) of the OECD Model contained therein reads as follows:

> As regards the application of the provisions of this 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 this Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

The case involved Martin Fowler, a qualified diver and a resident of South Africa. He undertook diving engagements in the waters of the UK Continental Shelf. The activity was therefore exercised in the United Kingdom. The question was whether article 7 of the treaty (article 7 OECD Model) or article 14 of the treaty (article 15 OECD Model) was applicable to the income. According to article 7, in the absence of a permanent establishment, the United Kingdom is not entitled to levy taxes. Under article 14 (article 15 OECD Model), the United Kingdom has the right to tax as the state where the activity is exercised. Under UK domestic law, Mr Fowler's income would be treated as employment income. However, an exception exists for divers according to section 15 of the Income Tax (Trading and Other Income) Act (ITTOIA): section 15 applies "if (a) a person performs the duties of employment as a diver or diving supervisor in the United Kingdom or in any area designated by Order in Council under section 1(7) of the Continental Shelf Act 1964 (c 29), (b) the duties consist wholly or mainly of seabed diving activities". According to section 15(2), "the performance of the duties of employment is instead treated for income tax purposes as the carrying on of a trade in the United Kingdom".[3]

The UK Supreme Court held:

> The starting point is that the question which of articles 7 and 14 of the Treaty applies to Mr Fowler's diving activities depends upon the true construction of those articles, in the context of the Treaty as a whole and its purposes, with the meaning of terms within those articles ascertained as required by article 3(2) by reference to UK income tax law. The relevant terms are, in article 7, "profits" and "enterprise of a contracting state" and, in article 14, "salaries, wages and other similar remuneration" and "employment".
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> […] Nothing in the Treaty requires articles 7 and 14 to be applied to the fictional, deemed world which may be created by UK income tax legislation. Rather they are to be applied to the real world, unless the effect of article 3(2) is that a deeming provision alters the meaning which relevant terms of the Treaty would otherwise have. This much is confirmed by paragraph 8(11) of the OECD Commentary quoted above, and it would be contrary to the requirement to treat the Treaty as a bilateral international agreement to do otherwise, as required by the dicta in the Anson case. Were it not for section 15 of ITTOIA, there would be no doubt that article 14, not article 7, would apply to Mr Fowler's diving activities, at least on the necessary but as yet untested assumption that he really was an employee. The meaning of "employment" is laid down in section 4 of

1. I want to thank Valentin Bendlinger for his critical comments and his support.
2. UK: SC, 20 May 2020, *Fowler v. Commissioners for Her Majesty's Revenue and Customs*, [2020] UKSC 22, Case Law IBFD.
3. For the background and purpose of this provision, *see* J. F. Avery Jones, *HMRC v Fowler: more on divers*, 62 BTR 4, at p. 385 et seq. (2017); J. Schwarz, *Article 3(2) of the OECD and UN Models: An International View*, 74 Bull. Intl. Taxn. 12, p. 46 (2020), Journal Articles & Opinion Pieces IBFD.

> ITEPA, and his remuneration plainly constitutes employment income within sections 6 and 7. UK tax law would not regard him as making profits from a trade, or his business as being that of an establishment.
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> […] So the question is whether section 15 gives a different meaning to the relevant terms. That is not how a deeming provision works generally, nor does section 15(2) in particular. Section 15(1) uses "employment" and "employment income" in exactly the same way as is prescribed by sections 4, 6 and 7 of ITEPA, and the phrase "performance of the duties of employment" in section 15(2) again uses "employment" in the same way. Section 15 is about the taxation of income arising from the performance of those duties of employment but, introduced by the word "instead", provides that the income is to be taxed as if, contrary to the fact, it was profits of a trade.
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> […] Section 15 also uses "trade" in its conventional sense and does not therefore alter the meaning of "enterprise" in article 7, it being common ground that enterprise is descriptive of a business, and that business includes trade. In short, nothing in section 15 purports to alter the settled meaning of the relevant terms of the Treaty, viewed from the perspective of UK tax law. Rather it takes the usual meaning of those terms as its starting point, and erects a fiction which, applying those terms in their usual meaning, leads to a different way of recovering income tax from qualifying divers.
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> […] Furthermore section 15 creates this fiction not for the purpose of deciding whether qualifying employed divers are to be taxed in the UK upon their employment income, but for the purpose of adjusting how that income is to be taxed, specifically by allowing a more generous regime for the deduction of expenses. This appears clearly from the express language of section 6(5) of ITEPA, which recognises that the income being charged to tax under section 15 is indeed employment income. If one asks, as is required, for what purposes and between whom is the fiction created, it is plainly not for the purpose of rendering a qualifying diver immune from tax in the UK, nor adjudicating between the UK and South Africa as the potential recipient of tax. It is for the purpose of adjusting the basis of a continuing UK income tax liability which arises from the receipt of employment income. Therefore, to apply the deeming provision in section 15(2) so as to alter the meaning of terms in the Treaty with the result of rendering a qualifying diver immune from UK taxation would be contrary to its purpose. It would also produce an anomalous result.
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> […] Nor should article 3(2) of the Treaty be construed so as to bring a qualifying diver within article 7 rather than article 14. To do so would be contrary to the purposes of the Treaty. This is because, as is recognised by article 2(1), the Treaty is not concerned with the manner in which taxes falling within the scope of the Treaty are levied. Section 15, understood in the light of section 6(5) of ITEPA, charges income tax on the employment income of an employed diver, but in a particular manner which includes the fiction that the diver is carrying on a trade.

22.2. "Unless the context otherwise requires"

It is regrettable that the Supreme Court almost ignored the phrase "unless the context otherwise requires".[4] Much suggests that this formulation expresses the precedence of an autonomous interpretation.[5] This principle applies broadly to international law treaties: they must be interpreted from within themselves and not in accordance with the respective national law.[6] A provision similar to article 3(2) of the OECD Model was first introduced in the DTC between the United Kingdom and the United States in 1945,[7] before it subsequently also became part of the OECD Model Convention of 1963. All of this went almost unnoticed, so it should not be assumed that the international law interpretation principles were to be turned on their head as a result of this provision. Furthermore, if each of the contracting states were allowed to interpret the DTC according to its national law, interpretation conflicts would be inevitable. The DTC provisions would be interpreted differently in the two countries and would thus fail to fulfil their task – the allocation of taxation rights between the two countries.[8] Moreover, it should not be overlooked that the OECD Model also contains explicit references to the law of one of the contracting states, as those in article 6(2) and article 10(3) of the OECD Model. These references would prove superfluous if article 3(2) of the OECD Model were to mean that the law of the applying state should be used for the interpretation of the convention.[9]

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4. Emphasizing the opportunity for the Court to consider the interpretation of "unless the context otherwise requires" before the case was decided D. Sanghavi, *Deeming Fictions in the Context of Tax Treaties – Analyzing Argument in HMRC v. Fowler*, 98 Tax Notes International 6, at pp. 675 and 679 (11 May 2020).
5. M. Lang, *Tax Treaty Interpretation – A Response to John F. Avery Jones*, 74 Bull. Intl. Taxn. 11, sec. 7. (2020), Journal Articles & Opinion Pieces IBFD; *see also* the opposite position, J.F. Avery Jones, *A Fresh Look at Article 3(2) of the OECD Model*, 74 Bull. Intl. Taxn. 11 (2020), Journal Articles & Opinion Pieces IBFD.
6. *See*, inter alia, J.M. Calderón & M.D. Piña, *Interpretation of Tax Treaties*, 39 Eur. Taxn. 10, sec. B., p. 379 et seq. (1999), Journal Articles & Opinion Pieces IBFD; *see also* M. Lang, *Introduction to the Law of Double Taxation Conventions* para. 69 et seq. (2nd edn, Linde 2013); and Lang, *supra* n. 5, at secs. 2 and 7.
7. J.F. Avery Jones et al., *The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD Model – I*, 19 BTR 1, at p. 18 et seq. (1984); in detail also M. Lang, *Qualification Conflicts – Global Tax Treaty Commentaries* sec. 2.3.3., Global Topics IBFD; J.F. Avery Jones, *"There is too much of this damned deeming"*, in *Tax Treaties After the BEPS Project – A Tribute to Jacques Sasseville* p. 29 (B.J. Arnold ed., Canadian Tax Foundation 2018).
8. Lang, *supra* n. 5, at sec. 6.
9. M. Lang, *Die Bedeutung von Verständigungsvereinbarungen nach Art 3 Abs 2 OECD-Musterabkommen 2017*, in *Territorialität und Personalität, Festschrift für Moris Lehner zum 70. Geburtstag* p. 217 et seq. (R. Ismer et al. eds., Otto Schmidt 2019); *see also* W. Gassner & M. Lang, *Double Non-Taxation of a Belgian Tax Law Professor Lecturing in Vienna?* in *Liber Amicorum Honouring Luc Hinnekens* at p. 227 (F. Vanistendael ed., Bruylant 2002), and Lang, *supra* n. 5, at sec. 7.

The Supreme Court might have been influenced by the fact that the phrase "unless the context otherwise requires" is also often used in UK domestic statutory legislation.[10] Usually this phrase has little relevance in English law texts but is obviously inserted so as to provide judges with a corrective in case the primarily applicable legal consequence does not make any sense in a specific individual case.[11] This phrase is also used in article 3(1) of the OECD Model, and here the context might have little relevance as well, for one can hardly imagine any situations in which the definitions contained there are to be thrust aside in the interpretation of those treaty provisions, which are using these defined terms.[12] The comparison between article 3(1) of the OECD Model and article 3(2) of the OECD Model, however, also suggests that the formulation "unless the context otherwise requires" can have a different meaning depending on the context in which it stands: in the case of article 3(2) of the OECD Model, an interpretation according to which terms should be readily understood according to the respective domestic law of the two applying states would provoke qualification conflicts, thus failing to achieve the objective and purpose of the treaty, namely the allocation of taxation rights between the two countries. Therefore, the "context" plays a much more important role in article 3(2) of the OECD Model so as to prevent such an unsatisfactory result.[13]

Avery Jones argued that the phrase "unless" indicates that the context should only be relevant in exceptional cases.[14] The OECD Commentary on this provision does not necessarily emphasize the exception element:[15] "the domestic law meaning of an undefined term applies only if the context does not require an alternative interpretation…". In my opinion, however, it makes no difference whether the formulation "unless the context otherwise requires" in article 3(2) of the OECD Model emphasizes its exceptional role or not.[16] The wording used in article 3(2) of the OECD Model makes it clear that an interpretation requiring the context of the treaty has priority over any recourse to domestic law, as domestic law may only be taken into account unless the context otherwise requires. Under the logical order of article 3(2) of the OECD Model, treaty definitions come first, context comes second and domestic law last.

This becomes even more unequivocal when one considers the words inserted in article 3(2) OECD of the Model in 2017: in addition to the insertion of "unless the context otherwise requires", it also contains the following formulation, which takes precedence over the use of domestic law: "or the competent authorities agree to a different meaning pursuant to the provisions of Article 25". This formulation clearly indicates that an interpretation from the context of the treaty takes precedence over a solution through mutual agreement procedures.[17] If, however, a solution was found by way of mutual agreement, one can hardly assume that as a result of the word "unless", this mutual agreement may only be considered in a rare exceptional case. Further, as a rule, the mutual agreement has to be ignored because in almost all cases the domestic meaning prevails. Therefore, under the 2017 version of article 3(2), it is even less likely that the consideration of the context of the treaty, which precedes the mutual agreement, may only apply in exceptional cases.[18] Therefore, one must now first resort to definitions of the treaty, second to the context (in the broadest sense), third to mutual agreements and only thereafter to domestic tax law.[19]

22.3. "Real world" versus fiction

The Supreme Court assumes that domestic law is relevant in deciding whether article 7 or article 14 (article 15 OECD Model) is applicable. However, the Court distinguishes between the "real world" and deeming provisions. In doing so, the Court takes the view that deeming provisions must not be taken into account.[20]

This distinction is not at all convincing. Under UK tax law, both employment and trade are defined for certain situations. It is completely arbitrary to allocate some parts of these definitions to the "real world" and others to "deeming provisions". Obviously, the term "instead" matters for the Court. However, this is just part of the legislative technique: the definitions consist of general rules and exceptions. If domestic law is relevant, there is no reason to just look at the general rule but not at the exception. The Court asks for what purposes the fiction was created and concludes that "it is plainly not for the purpose of rendering a qualifying diver immune from tax in the UK. Nor adjudicating between the UK and South Africa as the potential recipient of tax".[21] However, the question as such is irrelevant. It does not matter for what purpose the domestic provision was introduced. The other part of the definition of employment was not created for adjudicating between the United Kingdom and South Africa either. And if any parts of

10. J.F. Avery Jones et al., *The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD Model – II*, 19 BTR 2, at p. 93 et seq. (1984); *see also* Avery Jones et al., *supra* n. 7, at p. 18 (n. 14) and Avery Jones, *supra* n. 7, at p. 39 et seq.
11. Lang, *supra* n. 5, at sec. 7.
12. Id.
13. Id.
14. Avery Jones et al., *supra* n. 7, at p. 10 et seq.; recently, again, Avery Jones, *supra* n. 7, at p. 29 and 39 et seq.; *see also* Schwarz, *supra* n. 3, at p. 49.
15. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 3* para. 2 (21 Nov. 2017), Treaties & Models IBFD.
16. Lang, *supra* n. 5, at sec. 7; Lang, *supra* n. 7, at sec. 2.3.2.
17. Lang, *supra* n. 5, at sec. 7.
18. Id.
19. Id.
20. *Fowler*, *supra* n. 2, at para. 30.
21. Id., at para. 33.

the definitions were solely created in order to influence the allocation of the taxing rights, some would go so far as to ask whether such an act is abusive.[22]

It is interesting how the Supreme Court describes section 15 of the ITTOIA:[23] "[…] it takes the usual meaning of those terms as its starting point, and erects a fiction which, applying those terms in their usual meaning, leads to a different way of recovering income tax from qualifying divers." It is obvious that whenever a legislator defines a term, it does not make any sense to distinguish between the usual meaning and a fiction since the legislator is completely free to define terms like "employment" or "trade" in whatever way they like. However, one can only speculate whether the Supreme Court had a certain understanding of the treaty terms in mind, which it described as the "usual meaning", and which must not be reduced or extended by domestic law. Under this assumption, the Court would have been much better advised to explain why the treaty allows only a specific understanding of these terms. If the Court had taken this route consistently, it would have interpreted the treaty terms autonomously, without any reference to domestic law. The legal basis for this interpretation is the phrase "unless the context otherwise requires".[24]

22.4. Role of the OECD Commentaries

The Court finds its position, according to which the "deeming provision" is not relevant for the treaty provision, confirmed by the OECD Commentaries, in particular by paragraph 8(11) of the Commentary on Article 15 of the OECD Model.[25] The general statement of the Court in that context is interesting:[26] "The OECD Commentaries are updated from time to time, so that they may (and do in the present case) post-date a particular double taxation treaty. Nonetheless, they are to be given such persuasive force as aids to interpretation as the cogency of their reasoning deserves." In general, the Court does not consider a later version of the Commentaries as relevant. On the contrary, it completely depends on the "cogency of their reasoning". This means that a version of the Commentaries which was published after the conclusion of a tax treaty is not relevant as such. If everything depends on the reasoning, the Commentaries have a similar weight as publications by academics and other experts. If an author articulates a certain view, it will only be taken into consideration if the reasoning of the author is convincing.[27]

However, in that case one may have doubts as to whether the reasoning of the Commentaries is cogent or at least convincing. The sentences cited by the Court are the following:[28]

> The conclusion that, under domestic law, a formal contractual relationship should be disregarded must, however, be arrived at on the basis of objective criteria. For instance, a State could not argue that services are deemed, under its domestic law, to constitute employment services where, under the relevant facts and circumstances, it clearly appears that these services are rendered under a contract for the provision of services concluded between two separate enterprises. … Conversely, where services rendered by an individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises, that State should logically also consider that the individual is not carrying on the business of the enterprise that constitutes that individual's formal employer …

The Commentaries deal with the question whether a formal contractual relationship should be disregarded. Like most of the preceding paragraphs, the paragraph focuses on form versus substance issues. The OECD tries to make clear that the tax administrations should look at the "relevant facts and circumstances" but must arrive at their conclusions "on the basis of objective criteria".[29] It is the substance that counts, but administrations must not arbitrarily change the facts. The statement that "a State could not argue that services are deemed, under its domestic law, to constitute employment services where, under the relevant facts and circumstances, it clearly appears that these services are rendered under a contract for the provision of services concluded between two separate enterprises" has to be understood in that light: the rules which have to be applied to determine the facts of a case must not be abused to assume a completely different fact pattern on which the treaty rules have to be applied. However, this has nothing to do with the question of whether the reference to domestic law in article 3(2) of the OECD Model also covers domestic "deeming provisions".[30]

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22. *See also* J.F. Avery Jones et al., *Fowler v HRMC: Neither Fish nor Fowler: The Tax Treaty Implications of Domestic Deeming Rules*, 65 BTR 4, at p. 543 et seq. and p. 546. (2020); J. F. Avery Jones, *Commentary on Fowler v Revenue and Customs Commissioners*, 22 ITLR 1, at p. 686 (2020); Avery Jones, *supra* n. 3, at p. 396 et seq.
23. *Fowler*, *supra* n. 2, at para. 32.
24. Lang, *supra* n. 5, at sec. 7.
25. Para. 8.11 *OECD Model: Commentary on Article 15* (2017).
26. *Fowler*, *supra* n. 2, at para. 18.
27. Similar, *see* A. Jupp & J. Atkinson, *Fowler v. HMRC and the Murky Waters of Treaty Interpretation*, 73 Bull. Intl. Taxn. 6-7, sec. 4.3.2. (2020), Journal Articles & Opinion Pieces IBFD; and L. T. Pignatari, *Article 15(2) of the OECD Model and the International Hiring-Out of Labour: New Criteria Required?*, 74 Bull. Intl. Taxn. 8, sec. 2.2. (2020), Journal Articles & Opinion Pieces IBFD.
28. Para. 8.11 *OECD Model: Commentary on Article 15* (2017); *see also Fowler*, *supra* n. 2, at para. 17.
29. Para. 8.11 *OECD Model: Commentary on Article 15* (2017).
30. Similar, Avery Jones et al., *supra* n. 22, at p. 540-542.

22.5. Which country's domestic law?

The Supreme Court looked into UK tax law but did not give any reasoning as to why the United Kingdom's tax law and not South Africa's domestic law is relevant. The simple reason might be that the Court understands the reference to domestic law in article 3(2) of the OECD Model as meaning that each country's authorities have to take their own tax law into account. This is the common interpretation of article 3(2) of the OECD Model's reference to domestic tax law, leaving aside the issue as to under which circumstances domestic law might be relevant at all. If the different tax authorities take their own domestic tax law into account for treaty interpretation, it is obvious that double taxation or non-taxation may be the consequence.

Avery Jones assumes that a DTC provision is only "applied" when it limits a contracting state in the application of its domestic law. The state whose taxation right is confirmed by the DTC will only read the DTC.[31] The understanding of the word "applies" is not without controversy among academics whose first language is English. For example, Philip Baker does not share Avery Jones's opinion:[32] "The literal meaning of the words in Article 3(2) … appears to require each state to apply its own domestic law." However, it is interesting to consider what Avery Jones's position means for the case at hand: if, according to UK domestic law, article 14 of the treaty (article 15 OECD Model) is the relevant provision and therefore the United Kingdom maintains its taxation right, then, if one follows Avery Jones, the United Kingdom does not "apply" the treaty.[33] The taxation right of the United Kingdom is just confirmed by the treaty, so it only "reads" the treaty. But if the treaty provision is not "applied", then article 3(2) cannot come into play, since this provision is about the "application" of the provisions. So, if one looks into domestic law according to article 3(2) of the OECD Model in order to find out under which treaty provision certain income is covered, and learns that it is article 15 of the OECD Model and therefore the income may be taxed in that contracting state, and as a consequence the treaty is only read but not applied, one has to conclude that one must not have applied article 3(2) of the OECD Model from the start. In my view, this shows how circular this reasoning is.

22.6. Non-taxation?

The Supreme Court also made a statement on the consequences that would arise if the Court had come to a different solution than the one at which it finally arrived:

> In fact, such an outcome could mean that Mr Fowler was not taxable in either country, because the question whether he was taxable in South Africa would not be governed by the meaning of Treaty terms established by reference to UK tax law. He would probably be treated in South Africa as an employee. To the extent that domestic South African tax legislation did not tax the earnings of residents employed abroad he would not be taxable there or in the UK. There is no general provision in this Treaty, as there is in many others, to deal with what is called 'double non-taxation'. But the question whether South Africa did tax the earnings of its residents employed abroad was not investigated in these proceedings so it would be inappropriate to place any weight on this consideration in construing the Treaty.

However, the reasoning used by the Court some paragraphs later is, to a certain extent, contradictory to that statement: "[…] to apply the deeming provision in section 15(2) so as to alter the meaning of terms in the Treaty with the result of rendering a qualifying diver immune from UK taxation would be contrary to its purpose. It would also produce an anomalous result."[34] Obviously, the Court forgot that it would be "inappropriate to place any weight" on the possibility of non-taxation.[35]

It is not obvious that the result is "anomalous" if the treaty has to be understood in a way that prevents the United Kingdom from taxing the income. The Court is irritated by the fact that the final result is non-taxation. However, according to the facts given in the judgment, "domestic South African tax legislation did not tax the earnings of residents employed abroad". So, if South Africa does not levy any taxes, it is not obvious that the United Kingdom has to construe the treaty in a way that it may levy taxes.[36]

22.7. Conclusion: In dubio pro patria?

The result at which the Court arrived is not convincing for several reasons: the Court looked directly into domestic law, without considering whether the context otherwise requires. The judgment is a lost opportunity for an autonomous treaty interpretation. This is even more striking because the Court did not accept what it found under domestic law, but artificially distinguished between the "real world" and "deeming provisions". This distinction is not convincing at all. It is likely that the Court had been influenced by the probability of non-taxation, however, which was due to South African domestic legislation. Again, this judgment is another

31. Avery Jones et al., *supra* n. 7, at pp. 48 et seq.
32. P. Baker, *The Interpretation of Double Taxation Conventions*, in *Double Taxation Conventions* 3rd edn., E.21 (Sweet & Maxwell Tax Library).
33. Contrary to Avery Jones, others, in relation to *Fowler,* hold that the "state applying the Treaty is the UK", *see* Schwarz, *supra* n. 3, at p. 49.
34. *Fowler*, *supra* n. 2, at para. 33.
35. Avery Jones et al., *supra* n. 22, at p. 543 et seq.; Avery Jones, *supra* n. 22, at p. 682.
36. *See also* Avery Jones et al., *supra* n. 22, at p. 543 et seq.

example of a decision by which a domestic court confirmed its own country's taxing rights. This is a structural problem of tax treaties. Even if domestic judges are independent from the government, they live in the country and benefit themselves from the infrastructure which is provided by the local taxpayers. They are embedded in the society of that country. Therefore, it is not surprising that domestic courts reaching interpretation results which confirm the taxation rights of their own country is more the rule than the exception.