Triangular cases: The application of bilateral tax treaties in multilateral situations
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Chapter 4

The PE state and the non-discrimination principle

4.1. Introduction

In PE triangular cases, income may effectively taxed on a source basis in both the source state and the PE state. One of the key issues in such cases is whether, and to what extent, the PE state is obliged to grant double taxation relief for tax imposed in the source state. Without such relief PE triangular cases can result in unrelieved double taxation, since the residence state, on its own, may not be capable of providing sufficient relief. In addition, if relief is granted only in the residence state and not in the PE state, this may result in an inequitable distribution of tax revenues between those two states.

Given that PEs are generally not entitled to treaty benefits, the PE state will not have any relief obligation under its treaty with the source state (the PE-S treaty). However, under the PE non-discrimination article (Article 24(3)) of the treaty between the residence state and the PE state (the R-PE treaty), the PE state is obliged to ensure that the taxation of the PE is "not less favourably levied" than the taxation of a resident enterprise carrying on the same activities. As a result, the PE state may have an obligation to grant relief for tax imposed in third states; the scope of this obligation will be the main focus of this chapter.

4.2. The need for relief in the PE state and potential sources of relief obligation

4.2.1. The need for relief in the PE state

In PE triangular cases, the residence state may be in a position to fully relieve double taxation even if no relief is provided in the PE state, however this will not always be the case (as discussed in Chapter 3). In addition, even if the residence state can provide sufficient relief, it may come at the expense of tax revenue which the residence state would otherwise have collected in relation to other items of income. This arguably does not result in an equitable distribution of tax revenues between the residence state and the PE state. If the PE state does provide relief, then the combination of this relief and relief provided in the residence state will generally be capable of fully preventing unrelieved double taxation. These considerations suggest that if the PE state imposes tax on income which is also taxed on a source basis in a third state, then the PE state should be obliged to provide double taxation relief.


205 The residence state’s ability to provide sufficient relief will depend on a number of factors, including the relative tax rates in the three states involved and, where the residence state uses the credit method of relief, the applicable credit limitations and the ability to carry forward or carry back excess credits. This was discussed in detail in Chapter 3 (see Section 3.2.).

206 In particular, a lack of relief in the PE state may result in the residence state reducing the amount of tax it collects in relation to other items of income. For further discussion, and an example, refer to Chapter 3 (Section 3.2.2.2.).

207 See, for example: OECD Committee on Fiscal Affairs, "Triangular Cases," para 15.

208 OECD Model, Article 24(3).

209 See, for example: OECD Committee on Fiscal Affairs, "Triangular Cases," paras 30-2.

210 Some states do not impose tax on income derived by PEs from third states (see: Avery Jones, J.F., et al., "The Non-discrimination Article…" at p. 336); in these states, relief from double taxation is clearly not required in the PE state in PE triangular cases.

211 See Chapter 3, Section 3.2.2.2.

212 OECD Committee on Fiscal Affairs, "Triangular Cases", paras 18, 40. See also: Van Raad, K., "The 1992 OECD Model…"; García Prats, F.A., "Triangular Cases…".

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One argument that has been made against allowing relief in the PE state is that it may lead to a situation where the income is not taxed in any of the three states (commonly referred to as “double non-taxation”). Non-taxation of the income may occur if, for example; (i) the source state does not seek to impose tax on the income under its domestic law, (ii) the treaty between the residence state and the PE state requires the residence state to exempt the income attributable to the PE, and (iii) the PE state grants double taxation relief using the exemption method. However, in this example, the income would also escape taxation if it were derived by a resident of the PE state; the relief in the PE state merely places the PE in the same position as a resident enterprise of that state. In addition, the non-taxation of the income arguably arises from the combination of the domestic law of the source state and the relief in the PE state, and not solely as a result of the relief. PE triangular cases do raise tax avoidance concerns (which will be discussed in detail in Chapter 7), but these concerns should not result in double taxation relief being generally unavailable to PEs in all circumstances.

Of course, the PE state should not be required to provide any relief if the source state is prevented from imposing tax under the conditions of its treaty with the residence state (the R-S treaty). In general, the relief provisions of tax treaties only require relief in relation to income which the non-residence state may tax under the terms of the treaty. In PE triangular cases, however, the source state is generally bound by the conditions of the R-S treaty and not those of the PE-S treaty. Where the PE state uses the credit method of relief, the amount of the credit will be limited to the amount of tax imposed in the source state and thus there will naturally be no relief in the PE state if the source state is prevented from imposing tax under the terms of the R-S treaty. Where the exemption method applies, however, there may need to be an express limitation on the circumstances in which relief is required to ensure that the PE state does not exempt income that the source state is prevented from taxing under the R-S treaty. This should be distinguished from situations where the source state may impose tax under the R-S treaty but chooses not to exercise its taxing rights; in such cases the PE state should continue to grant the exemption in the same way that the residence state would continue to grant an exemption in a bilateral case. The possible mechanisms for requiring the PE state to grant relief will be discussed in detail in Chapter 7.

Double taxation could also theoretically be prevented by the source state providing relief for tax imposed in the PE state, but to my knowledge, such a solution has never been suggested. It would also be inconsistent with the way in which the treaty articles dealing with passive income operate, in that they allow the source state to impose a certain rate of tax by reference to the gross amount of the income. By contrast, under Article 7, the income attributable to a PE is taxed on a net basis. The similarities between PE taxation and residence-based taxation (which are discussed in depth in Chapter 5) also support the provision of relief in the PE state, given that in cases of international double taxation it is typically the residence state which is charged with providing relief. Thus, the basis for the discussion in this chapter is that relief should be provided in the PE state for tax imposed in the source state, and not vice versa.

### 4.2.2. Potential sources of relief obligation

There are various sources of law which may give rise to an obligation for the PE state to grant relief in PE triangular cases; each of these sources will be discussed briefly in this section.

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213 Jann, M., "How Does Community Law…."); ECJ, 21 September 1999, Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt, C-307/97, para 61 (The ECJ did not consider this argument to be relevant because there was no risk that the profits in question would not be taxed in any country (see para 62.).

214 Jann, M., "How Does Community Law….


216 Limitations on the amount of credit relief in the PE state are discussed in detail in Section 4.3.5., below.

4.2.2.1. Domestic law

Many countries extend their domestic relief provisions to apply to income derived by non-residents through local PEs (or in situations where an equivalent domestic law threshold is satisfied), either in full or in part.\(^{218}\) In these countries, income which has been taxed on a source basis in a third state may give rise to a foreign tax credit or the income may be exempt, provided the domestic requirements for relief are satisfied. For example, in the United States a specific provision allows non-residents with a US "trade or business" to claim credits for foreign taxes on income which is "effectively connected" with that trade or business.\(^{219}\) Similarly, Australia's foreign tax credit rules apply to PEs of non-residents in the same way as they apply to residents.\(^{220}\) Other states, including the UK and Canada, only grant unilateral relief to PEs in certain circumstances. In the UK, for example, foreign tax credits may be available under domestic law in relation to income derived through a UK branch, but only if that income represents interest derived by a UK branch of a bank or insurance company.\(^{221}\) Similarly, in Canada, credit relief may be available to Canadian branches of authorised foreign banks.\(^{222}\) Certain other states restrict their unilateral double taxation relief measures to resident taxpayers and thus, do not grant any double taxation relief to PEs under their domestic law.\(^{223}\) Alternatively, the PE state may not grant any double taxation relief under domestic law, even to resident taxpayers, in which case domestic relief would clearly not be available in relation to income derived by local PEs.\(^{224}\)

4.2.2.2. European law

Following the European Court of Justice (ECJ) decision in the *Saint-Gobain* case,\(^ {225}\) it is clear that European law requires the PE state in PE triangular cases to provide relief for source state taxation to the extent that such relief would be available to a resident of the PE state, provided that both the residence state and the PE state are within the European Union (EU). The impact of EU law on PE triangular cases is beyond the scope of this thesis, however, it is important to note that (depending on the states involved) it may give rise to a relief obligation in the PE state. In addition, the non-discrimination principles discussed in the *Saint-Gobain* case may be relevant to the interpretation of the non-discrimination obligation that arises under the R-PE treaty\(^ {226}\) (discussed below). Section 4.3.7. contains a brief

\(^{218}\) OECD Committee on Fiscal Affairs, "Triangular Cases," para 30.

\(^{219}\) Section 906, IRC. This section provides as follows: "(a) A nonresident alien individual or foreign corporation engaged in trade or business within the United States during the taxable year shall be allowed a credit under section 901 for the amount of income, war profits, and excess profits taxes paid or accrued during the taxable year... to any foreign country or possession of the United States with respect to income effectively connected with the conduct of a trade or business within the United States."

\(^{220}\) Explanatory Memorandum to the Tax Laws Amendment (2007 Measures No. 4) Bill 2007, p. 18. Under Australia's Foreign Income Tax Offset Rules (FITO), a credit may be available "...where a foreign resident pays income tax in a foreign country on an amount that is included in their assessable income (under Australian tax law) and such tax is imposed because the income is sourced in that country. By contrast, where a foreign country imposes tax on the amount included in an entity's assessable income merely because it is a resident of that country (that is residence-based taxation), a foreign income tax offset entitlement does not arise if the tax is imposed on income from a source outside the foreign country." (Australian Taxation Office, "Guide to Foreign Income Tax Offset Rules 2009-10," available at http://www.ato.gov.au/corporate/content.asp?doc=/content/00238031.htm&page=1&H1, viewed 20 September 2010.) There is no specific section providing for this treatment; the new rules simply no longer include the requirement that the person claiming the foreign tax credit is a resident of Australia.

\(^{221}\) Section 794(1) and Section 794(2)(c), Income and Corporation Taxes Act 1988. See also: Avery Jones, J.F. & Bobbett, C. "Triangular Treaty Problems...".


\(^{224}\) Rohatgi, R., *Basic International Taxation* at p. 279.


\(^{226}\) See: Vanistendael, F., "Taxation and Non-Discrimination, A Reconsideration of Withholding Taxes in the OECD" 2 *World Tax Journal* 2, (2010), pp. 175-191. See also, reporting on a seminar which discussed, inter alia, the relevance of the non-discrimination jurisprudence of the European Court of Justice (ECJ) for bilateral tax treaties.
comparison between the non-discrimination principles expressed in Article 24(3) of the OECD Model and those of EU law.

4.2.2.3. The treaty between the PE state and the source state

A PE is generally not considered a resident of the PE state for treaty purposes, and as a result, the PE-S treaty will not apply to income derived by the PE. To the extent that the PE-S treaty follows the OECD Model, the PE state will therefore have no obligation under that treaty to grant double taxation relief in relation to income derived by the PE. It may be possible, however, for the PE-S treaty to contain specific provisions extending treaty benefits to PEs; the possibility of extending treaty benefits to PEs will be discussed in Chapters 7, 8 and 9.

4.2.2.4. The treaty between the residence state and the PE state

As mentioned above, the PE state may have an obligation to grant relief for taxes imposed in the source state under the non-discrimination article (Article 24(3)) of the R-PE treaty, however, the extent of this obligation is subject to debate. It is quite clear that the non-discrimination article obliges the PE state to extend domestic relief provisions to PEs, but whether the PE state is also obliged to extend treaty relief to PEs (i.e., relief equivalent to that which would be available to a resident enterprise of the PE state under the PE-S treaty) is more controversial. The remainder of this chapter explores the scope of the PE state's relief obligation under the non-discrimination article of the R-PE treaty.

4.3. The PE non-discrimination principle and double taxation relief

4.3.1. Introduction to Article 24(3)

The purpose of Article 24(3) is to ensure that non-resident enterprises conducting business activities in a particular state are not put at a disadvantage, from a tax perspective, in comparison to enterprises carried on by residents of that state. Article 24(3) provides:

"The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities." 229

The term "enterprise of a Contracting State" is defined in Article 3 to mean "an enterprise carried on by a resident of a Contracting state." Thus, the subject of the PE non-discrimination clause, and the person entitled to benefit from it, is the person carrying on business through a PE (who is resident in the other contracting state). In a PE triangular case, it is therefore the non-discrimination article of the R-PE treaty which must be considered in determining whether the PE state is obliged to grant relief. The non-discrimination article of the R-S treaty is irrelevant, as is the non-discrimination article of the PE-S treaty, since neither of these treaties apply in the PE state with respect to the income arising in a PE triangular case.


227 See, for example: OECD Committee on Fiscal Affairs, "Triangular Cases", para 15; Avery Jones, J.F., & Bobbett, C., "Triangular Treaty Problems…".

228 Van Raad, K., "Nondiscrimination… at p. 127.

229 Article 24(3) continues: "This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents." This sentence is not relevant for the present analysis.

230 Article 3(1)(d), OECD Model.

231 Van Raad, K., "Nondiscrimination… at p. 133.

232 See, for example: OECD Committee on Fiscal Affairs, "Triangular Cases," para. 15; Van Raad, K., "The 1992 OECD Model…".
To determine whether the PE state contravenes Article 24(3) of the R-PE treaty by not granting relief, it is necessary to compare the tax burden imposed on the PE in the PE state to the tax burden which would be imposed on a resident enterprise carrying on the same activities. For the purposes of this comparison, it is only the result that must be considered; differential tax treatment of PEs is permitted so long as it does not produce a less favourable result.233 Furthermore, consideration is limited to the tax imposed in the PE state; the PE state is not required to compensate for less favourable treatment elsewhere, and more favourable treatment elsewhere does not justify a greater tax burden in the PE state.234 In general terms, the object of comparison is a resident enterprise "that has a legal structure similar to that of the enterprise to which the PE belongs."235 Thus, if the PE is operated by a company then the taxation of the PE should be compared to the taxation of a company resident in the PE state and carrying on the same activities as the PE.236 The object of comparison will be discussed further below, along with the meaning of the term "carrying on the same activities" (see Sections 4.3.3., 4.3.4. and 4.3.5.).

4.3.2. Obligation to extend unilateral relief to PEs

It is widely accepted that in PE triangular cases, the PE state is obliged to extend any unilateral relief measures which are available to resident enterprises to the PE in order to satisfy the requirements of Article 24(3) of the R-PE treaty.237 If such relief is not extended to PEs, then a non-resident deriving income through a local PE would generally be subject to a higher tax burden in the PE state than a resident enterprise carrying on the same activities and the PE state would contravene Article 24(3). While the OECD Commentary refers only to the extension of credit relief,238 there seems to be no basis for denying the extension of unilateral relief to PEs where the PE state provides relief to resident taxpayers using the exemption method.239 Thus, the PE should be entitled to the relief available to resident enterprises under the domestic law of the PE state, regardless of whether the PE states provides relief using the credit method or the exemption method.

In practice, not all states extend their domestic double taxation relief measures to PEs in accordance with the non-discrimination provisions of tax treaties.240 In a case in the UK, for example, the PE of a Canadian insurance company was denied relief even though the court accepted that an obligation to provide relief equivalent to that available to residents under domestic law existed under the non-discrimination article of the Canada-UK treaty.241 Relief was denied on the basis that the legislation giving effect to the treaty did so subject to certain provisions of domestic law, including the provision limiting relief solely to residents, which was said to override the treaty.242 This reasoning is generally considered to be contrary to Article 27 of the Vienna Convention, which provides that: "A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty."243 Other states simply do not accept that the PE non-discrimination provision obliges them to grant unilateral relief to PEs at all.244

233 OECD Commentary on Article 24, para. 34. See also: Van Raad, K., Nondiscrimination..., at p. 141; Vogel, K., Engelschalk, M., & Görl, M., Klaus Vogel on Double Tax Conventions..., at p. 1316 (m.no. 126).
235 OECD Commentary on Article 24, para 37.
236 Van Raad, K., Nondiscrimination..., at p. 137.
238 OECD Commentary on Article 24, para 67.
239 Van Raad, K., "The 1992 OECD Model...".
243 Avery Jones, J.F., et al., "The Non-discrimination Article...."
244 OECD Committee on Fiscal Affairs, "Triangular Cases", para. 30. The extent to which this is still the case is not clear, but it seems likely that there are at least some states which continue to maintain this position.
In some states, unilateral relief measures are not available in relation to income which is considered to have a domestic source under domestic law. Even if such states accept that the PE non-discrimination article requires them to extend their unilateral relief measures to PEs, no relief would generally be available in such states to the extent that the income attributable to the PE is considered to be domestic source income. This could occur, for example, as a result of the business activities conducted by the PE in the PE state. This may be quite a common situation since the income is derived by a non-resident and thus, would generally only be taxed in the PE state if it is considered to be locally sourced income. In addition, not all states grant relief to resident enterprises under domestic law, in which case there is clearly no domestic relief which could be extended to PEs on the basis of the non-discrimination provision.

Given that relief may not always be available to PEs by the extension of domestic law relief provisions under non-discrimination principles, or alternatively, that such relief may be less favourable than the treaty relief available to resident enterprises, it is also important to consider whether the relief available to resident enterprises under the PE-S treaty should also be available to PEs under the non-discrimination article of the R-PE treaty. This issue is considered in the following section.

### 4.3.3. Obligation to extend treaty relief to PEs

This section discusses whether PEs should be entitled to double taxation relief in the PE state equivalent to that which is available to residents of the PE state under the PE-S treaty. Such relief is referred to herein as "treaty relief" but it should be borne in mind that to the extent that such relief is available, it is available only as a result of the obligations imposed on the PE state by the non-discrimination article of its treaty with the residence state; the PE is not entitled to treaty benefits and cannot claim relief directly under the treaty between the PE state and the source state.

#### 4.3.3.1. Preliminary analysis

The OECD Commentary does not take a clear position on whether treaty relief should be available to PEs in PE triangular cases under Article 24(3), but instead suggests wording which could be included in the treaty between the PE state and the residence state to specifically allow the PE to claim such relief. It does not appear that this proposed wording has been adopted in any concluded treaty. This may reflect a reluctance to extend treaty relief to PEs; states may prefer to rely on the relief provisions of their domestic law or even to deny relief. Alternatively, to the extent that states do wish to extend treaty relief to PEs, they may consider it that this is already required (or at least possible) under the existing wording of Article 24(3).

The basic starting point for the application of Article 24(3) is that the tax imposed on the PE in the PE state should not be "less favourably levied" than that which would be imposed on a resident entity carrying on the same activities. The legal framework that must be taken into account for comparing the

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245 This was the case in Australia, for example, prior to changes to the foreign tax credit rules in 2008: Section 160AF, Income Tax Assessment Act 1936 (repealed by the Tax Laws Amendment (2007 Measures No. 4) Act, 2007, with effect from income years starting after 1 July 2008).
246 Avery Jones, J.F., & Bobbett, C., "Triangular Treaty Problems…."  
247 The 1977 OECD Commentary on Article 24, paras. 52 and 54, stated that such relief should not be available on the basis of Article 1 and the relative effect of treaties, however these comments were removed in the 1992 Commentary.  
248 OECD Commentary on Article 24, para. 70. The suggested wording is as follows: "When a permanent establishment of an enterprise of the other Contracting State receives dividends or interest from a third State and the holding or debt-claim in respect of which the dividends or interest are paid is effectively connected with that permanent establishment, the first-mentioned State shall grant a tax credit in respect of the tax paid in the third State on the dividends or interest, as the case may be, by applying the rate of tax provided in the convention with respect to taxes on income and capital between the State of which the enterprise is a resident and the third State. However, the amount of the credit shall not exceed the amount that an enterprise that a resident of the first-mentioned State can claim under that State's convention on income and capital with the third State."  
249 Based on a search of IBFD's tax treaty database, conducted 30 September 2010.  
250 See, for example: OECD Committee on Fiscal Affairs, "Triangular Cases", para. 31.
tax imposed on a PE to the tax imposed on a hypothetical resident enterprise carrying on the same activities includes all the provisions which are normally applicable to such an enterprise, including the provisions of tax treaties.\footnote{García Prats, F.A., "Triangular Cases..."; Martín Jiménez, A.J., García Prats, F.J., & Calderón Carrero, J.M., "Triangular Cases..."; Zhai, G., "Triangular Cases...".} The comparison required by Article 24(3) is not limited to the result of applying the domestic laws of the PE state.\footnote{García Prats, F.A., "Triangular Cases..."; Martín Jiménez, A.J., García Prats, F.J., & Calderón Carrero, J.M., "Triangular Cases..."; Zhai, G., "Triangular Cases...".} In PE triangular cases there is thus, in my view, no basis for confining the comparison to the relief available under the domestic law of the PE state and ignoring the result of relief provided to resident enterprises of the PE state under tax treaties.\footnote{García Prats, F.A., "Triangular Cases..."; Martín Jiménez, A.J., García Prats, F.J., & Calderón Carrero, J.M., "Triangular Cases..."; Zhai, G., "Triangular Cases...".} Where the resident enterprise to which the PE is being compared (referred to herein as the "comparison entity") would be entitled to relief under a treaty between the PE state and the source state then, unless equivalent relief is granted to the PE, the tax burden imposed on the PE would, all other things being equal, be greater than the tax burden which would be imposed on the resident enterprise.\footnote{Avery Jones, J.F., et al., "The Non-discrimination Article..."; Van Raad, K., "Issues in the Application of..."; Friedhelm, J., "Discriminatory Tax Treatment..."; García Prats, F.A., "Triangular Cases...".} In principle, therefore, the PE state should be obliged to extend treaty relief to PEs in accordance with the non-discrimination article of the R-PE treaty. Extension of treaty relief to PEs under non-discrimination principles may, however, result in an unbalanced application of the PE-S treaty and may therefore be undesirable from a policy perspective without a corresponding application of the PE-S treaty in the source state (this will be discussed further in Chapter 7).

\subsection*{4.3.3.2. Comparison entity’s eligibility for treaty benefits}

For treaty relief to be extended to the PE in accordance with non-discrimination principles, it is essential that the comparison entity would be entitled to relief under the treaty between the PE state and the source state. Determining whether it would be entitled to such relief requires establishing the characteristics of the comparison entity and then hypothetically applying the PE-S treaty. In order for the comparison entity to be eligible for relief under the PE-S treaty, it must fulfil three basic conditions; (i) it must be a resident of the PE state for the purposes of the PE-S treaty, (ii) it must be considered to derive income to which the PE-S treaty would apply (i.e., from sources in State S), and (ii) it must be eligible for relief under the relief provision of the PE-S treaty. Each of these conditions will be discussed in turn below.

\subsubsection*{Residence for the purposes of the PE-S treaty}

For the purposes of Article 24(3) of the R-PE treaty, the PE is being compared to an enterprise which is carried on by a resident of the PE state within the meaning of the term "resident" under the R-PE treaty.\footnote{The term "resident" is a defined term for the purposes of the R-PE treaty. Article 4 of the OECD Model provides that: "For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein."} It does not necessarily follow that the comparison entity will be a resident of the PE state for the purposes of the PE-S treaty, given that determining residence for the purposes of the PE-S treaty would require the application of the definition contained in the PE-S treaty. Under the OECD Model, however, the definition of residence refers to domestic law, treating an entity as a resident of a particular state for treaty purposes if it is resident under the domestic laws of that state.\footnote{OECD Model, Article 4.} It therefore seems likely that in most cases, the comparison entity will be considered to be resident in the PE state for the purposes of the PE-S treaty.
For the purposes of the following analysis, it will be assumed that the comparison entity is a resident of the PE state for the purposes of the PE-S treaty. The comparison entity’s eligibility for treaty benefits under the PE-S treaty will be discussed further in Section 4.3.4., which deals with PEs belonging to partnerships and treaties containing Limitation on Benefits (LOB) provisions.

**Source of income**

The comparison entity would only be entitled to relief under the PE-S treaty if it derived income to which the PE-S treaty applied (i.e., from sources in the source state); therefore, in order for treaty relief to be available to the PE, the PE must be compared to an enterprise that earns the same income as the PE from the same geographical sources. Article 24(3) requires that the taxation imposed on the PE is compared to the taxation imposed on an enterprise of the PE state "carrying on the same activities" as the PE. Therefore, relief will only be required if the "same activities" requirement means that the comparison entity is considered to derives income from the same geographical sources as the PE.

One approach which has been suggested is to compare the PE to all resident enterprises of the PE state carrying on the same activities (e.g., all resident enterprises in the same industry), including those which earn income from non-treaty states. In this case, no treaty relief would be available to the comparison entity, and thus, no treaty relief would be available to the PE. The problem with this approach is that there does not seem to be any basis for limiting the term "same activities" to the type of activities carried on. The better comparison, particularly in light of the objective of Article 24(3), seems to be to a resident enterprise that carries on the exact same activities as the PE, including earning the same income from the same geographical sources.

**Availability of relief under the relief provision of the PE-S treaty**

The relief provisions of the OECD Model require the residence state to grant relief for tax imposed in the source state to the extent that the terms of the treaty permit the source state to impose tax on the income. In considering whether the comparison entity would be entitled to relief under the PE-S treaty, it is therefore important to consider whether the source state would have been entitled to impose tax on the income under the terms of the PE-S treaty if that income had been derived by a resident of the PE state. If the source state would have been prevented from imposing tax on the income then no relief should be available to the comparison entity under the PE-S treaty (either credit or exemption) and consequently, no such relief should be available to the PE.

In most cases where the terms of the PE-S treaty would prevent the source state from imposing tax on the income (if it applied), the source state will in fact be prevented from imposing tax on the income attributable to the PE by the application of the R-S treaty (assuming both treaties follow the OECD Model). Where the source state is prevented from imposing tax under the R-S treaty, there should clearly be no relief in the PE state. However, if there is no R-S treaty, or if there is a difference between the terms of the R-S treaty and the PE-S treaty, then the source state may impose tax in circumstances where it would be prevented from imposing tax under the PE-S treaty if the income were derived by a

257 Avery Jones, J.F., et al., "The Non-discrimination Article…." It has also been argued that the PE should be compared to a resident enterprise engaging only in domestic activities (in which case no relief would be available) (see: Blahova, R., "Treaty Benefits…," at p. 92); the difficulty with this is that it seems hard to consider purely domestic activities to be the "same activities" as those carried on by the PE. In addition, if the comparison were limited to an enterprise with purely domestic activities, then the PE state would also have no obligation to extend domestic relief measures to PEs under non-discrimination principles, which is clearly not correct.

258 Article 23A ("Exemption Method") and Article 23B ("Credit Method").

259 Under various articles of the OECD Model, the source state is prevented from imposing tax on particular categories of income, including business profits (in the absence of a PE) (Article 7), royalties (Article 12), certain capital gains (Article 13), and other income (Article 21). For analysis, refer to Chapter 2.

260 This is the case with respect to business profits (Article 7), income from shipping, inland waterways transport and air transport (Article 8), certain types of capital gains (Article 13) and "other income" (Article 21). Refer to Chapter 2 for further detail.
resident of the PE state. If this were the case, then the comparison entity would generally not be entitled to relief under the PE-S treaty, and thus, prima facie, no relief should be available to the PE.

This will depend, however, on the comparison which is made for the purposes of applying Article 24(3), i.e., whether the PE is being compared to a resident enterprise which is earning the same income as the PE and paying the same tax in the source state as was actually paid by the PE or, alternatively, whether it is being compared to a resident of the PE state which earns the same income as the PE from the same sources and paying the amount of tax in the source state that a resident enterprise would pay. This is discussed in greater detail below (in Section 4.3.5.) in relation to the amount of relief which should be provided in the PE state.

4.3.3.3. Arguments against extending treaty relief to PEs

One of the primary arguments against extending treaty relief to PEs under the non-discrimination principle is based on the relative (or bilateral) effect of treaties.261 According to this principle, treaty benefits may not be extended to residents of third states.262 In the context of treaty relief for PEs, it is argued that the PE should not be entitled to relief because, for the purposes of the PE-S treaty, the PE is not a resident of either contracting state and thus does not satisfy the requirements of Article 1.263 However, the fact that the PE is not entitled to the benefits of the PE-S treaty should not prevent the PE state from granting equivalent relief in order to place the PE in the same position as a resident taxpayer. Granting such relief does not represent an extension of the personal scope of the PE-S treaty because the PE state's obligation to grant relief does not arise under the PE-S treaty. Rather, it arises under Article 24(3) of the R-PE treaty and as a result of the application of the PE-S treaty's relief provisions to eligible residents of the PE state.264 This view is supported by the fact that there are no additional obligations imposed on the source state and the rights of the source state are in no way affected.265 The source state is free to apply its tax laws to the income attributable to the PE without any limitation under the PE-S treaty. In addition, where the application of Article 24(3) of the R-PE treaty requires the PE state to grant relief equivalent to that available to resident enterprises, it should not be possible to invoke Article 1 of the PE-S treaty to limit the amount of relief available and, in effect, to fail to meet the obligation arising under Article 24(3) of the R-PE treaty.266

Another common (and related) argument against extending treaty relief to PEs is that if such relief were provided, it would upset the balance and reciprocity of the treaty between the PE state and the source state.267 Tax treaties are based on the principle of reciprocity; the idea that each contracting state gives up

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261 The 1977 OECD Commentary on Article 24, paras. 52 and 54, stated that treaty relief should not be available on the basis of Article 1 and the relative effect of treaties, however these comments were removed in the 1992 Commentary. This argument was also presented by Van Raad (Van Raad, K., *Nondiscrimination…*, at p. 153, but contra: Van Raad, K., "Issues in the Application…" and Van Raad, K., "The 1992 OECD Model…". Vogel has stated that treaty relief should not be available to PEs, but without presenting the reasoning behind this view (Vogel, K., Engelschalk, M., & Görl, M., *Klaus Vogel on Double Tax Conventions…*, at pp. 1317-8, (m.no. 129)). The relative effect of treaties has been identified as a primary argument against granting treaty relief to PEs by various authors, including: Avery Jones, J.F., et al., "The Non-discrimination Article…" at p. 337 (referring to paragraphs 52 and 54 of the 1977 OECD Commentary); García Prats, F.A. "Triangular Cases…"; Martín Jiménez, A.J., García Prats, F.J., & Calderón Carrero, J.M., "Triangular Cases…"; Friedhelm, J., "Discriminatory Tax Treatment…" (referring to several German authors); Zhai, G. "Triangular Cases…".

262 IFBD International Tax Glossary, p. 335.


264 García Prats, F.A., "Triangular Cases…".


266 García Prats, F.A., "Triangular Cases…” (see particularly note 48); Martín Jiménez, A.J., García Prats, F.J., & Calderón Carrero, J.M., “Triangular Cases…”.

267 For example, this was presented as an argument against requiring the PE state to grant relief in the *Saint-Gobain* case (ECJ, 21 September 1999, *Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt*, C-307/97, paras 59-60).
certain taxing rights under a treaty in exchange for the other contracting state agreeing to do the same.\textsuperscript{268} If one state is required to extend the relief available under a treaty to income attributable to PEs of residents of third states then, so the argument runs, the reciprocity of the treaty is compromised because the PE state is required to sacrifice tax revenue with no corresponding sacrifice in the source state. The reciprocity argument was soundly rejected in the \textit{Saint-Gobain} case,\textsuperscript{269} in which the ECJ was clearly of the view that the balance and reciprocity of the treaties between the PE state (in this case, Germany) and the source states (Switzerland and the US) would not be disturbed by the allowance of double taxation relief in the PE state.\textsuperscript{270} While the \textit{Saint-Gobain} case was decided on the basis of EU law, and partly with respect to economic rather than juridical double taxation,\textsuperscript{271} the arguments regarding the impact on the balance and reciprocity of treaties are equally relevant where the potential extension of treaty relief arises under tax treaty non-discrimination principles. The ECJ noted that the obligation imposed on the PE state by EU law did not affect in any way the obligations arising from the treaties with the source states\textsuperscript{272} and likened the double taxation relief to be provided under non-discrimination principles to a unilateral extension of relief in the PE state.\textsuperscript{273} The ECJ also noted that the German legislature had never considered that the provisions of double tax treaties precluded any unilateral renunciation of taxing rights, and that the balance and reciprocity of the treaties would not be called into question by a unilateral extension of relief measures to PEs.\textsuperscript{274} Similarly, if Article 24(3) of the R-PE treaty requires the PE state to extend treaty relief to a PE, then from the perspective of the PE-S treaty, that relief is, in a sense, equivalent to a unilateral extension of relief by the PE state. For these reasons, the relief obligation should not be considered to upset the balance and reciprocity of the PE-S treaty.

The balance and reciprocity argument is also complicated by the fact that the state which is on one occasion the "source state" may on other occasions be the "PE state." Thus, the overall impact on the tax revenues collected by the two states (the balance of the treaty) is difficult to assess and will depend on the relative levels of investment, the prevalence of triangular structures in each state (and in particular, on the prevalence of PEs of non-residents which derive income from the other state),\textsuperscript{275} and the domestic tax laws of each state.\textsuperscript{276} The reciprocity argument also fails to take into account the potential impact of denying relief on the balance and reciprocity of the R-PE treaty. If the state which is, in this case, the residence state entered into the R-PE treaty with the view that Article 24(3) requires the state where a PE is located to extend treaty relief to PEs, and the first state (State R) does in fact grant such relief to PEs

\begin{itemize}
\item \textsuperscript{268} IBFD International Tax Glossary, p. 329.
\item \textsuperscript{269} ECJ, 21 September 1999, \textit{Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt}, C-307/97. The \textit{Saint-Gobain} case concerned a German PE of a French company which received dividends from companies resident in various countries. It involved a request for three tax concessions with respect to the dividends received by the PE on the basis of the non-discrimination principles of EU law (specifically, the freedom of establishment). These concessions were: (1) an exemption from the German corporation tax for dividends received from companies resident in the US and Switzerland which was available to German resident companies under the treaties concluded between Germany and those states; (2) an indirect tax credit for taxes imposed on the profits from which foreign dividends were paid which was available to German resident companies under German domestic law; and (3) A capital tax concession available to German resident companies under German domestic law.
\item \textsuperscript{270} ECJ, 21 September 1999, \textit{Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt}, C-307/97, paras 59-60.
\item \textsuperscript{271} The \textit{Saint-Gobain} case involved a request for three tax concessions with respect to the dividends received: (1) an exemption from German corporation tax for dividends received from companies resident in the US and Switzerland, which was available to German resident companies under the treaties concluded between Germany and those states; (2) an indirect tax credit for taxes imposed on the profits from which foreign dividends were paid available to companies resident in Germany under German domestic law; and (3) a capital tax concession available to German resident companies under German domestic law (ECJ, 21 September 1999, \textit{Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt}, C-307/97, paras 16-22.
\item \textsuperscript{272} ECJ, 21 September 1999, \textit{Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt}, C-307/97, para 59.
\item \textsuperscript{273} ECJ, 21 September 1999, \textit{Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt}, C-307/97, para 59.
\item \textsuperscript{274} ECJ, 21 September 1999, \textit{Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt}, C-307/97, para 60.
\item \textsuperscript{275} Assuming the principle of granting treaty relief to PEs under non-discrimination principles is applied consistently by both states.
\item \textsuperscript{276} For example, the extent to which PEs are taxed on income from sources in third states and the extent to which relief is available under domestic law.
\end{itemize}
located within its borders, then the failure of the other state (State PE) to extend treaty relief to PEs arguably upsets the balance and reciprocity of the R-PE treaty.\textsuperscript{277}

The non-application of the conditions of the PE-S treaty in the source state suggests, however, that the extension of treaty relief to the PE would not be appropriate, even if it may be technically required under the terms of the R-PE treaty. Without a corresponding application of the conditions of the PE-S treaty in the source state in relation to the income attributable to the PE, the extension of treaty relief in the PE state results in an unbalanced application of the PE-S treaty being unbalanced. This could be resolved by also requiring the source state to apply the conditions of the PE-S treaty in relation to the income attributable to the PE (this will be revisited in later chapters).

\textbf{4.3.3.4. Conclusions}

It has been argued above that the PE non-discrimination provision in Article 24(3) of the R-PE treaty imposes an obligation on the PE state to extend treaty relief to PEs in PE triangular cases. If such relief is not granted, then the tax imposed on the PE is arguably less favourably levied than that which would be imposed on a resident enterprise carrying on the same activities, and the PE state contravenes Article 24(3). Neither the principle of the relative effect of treaties nor the reciprocity principle offers sufficient justification for failing to extend double taxation relief to PEs equivalent to that which would be available to a resident enterprise under the PE-S treaty. It would, however, be preferable for the PE state to have an explicit obligation to extend treaty benefits to PEs to remove any doubt regarding the extent to which it is required to grant relief. In addition, the extension of treaty relief to PEs may be considered problematic from a policy perspective unless there is a corresponding application of the conditions of the PE-S treaty in the source state because it results in an unbalanced application of the PE-S treaty. As will be discussed in Chapter 5, the source state should also be required to apply the conditions of the PE-S treaty in relation to income attributable to the PE, in which case the potentially unbalanced application of the PE-S treaty would no longer be an issue.

\textbf{4.3.4. Comparison entity's eligibility for treaty benefits in special circumstances}

Regardless of the general requirement for relief discussed above, the PE state will not have any obligation to extend treaty relief to a PE the extent that the comparison entity would not be entitled to relief under the PE-S treaty. This section discusses the comparison entity’s eligibility for relief under the PE-S treaty in situations where the PE belongs to a partnership and in situations where the PE-S treaty contains a limitation on benefits (LOB) provision which restricts eligibility for treaty benefits. In such cases, it may be difficult to demonstrate that the comparison entity should be entitled to relief under the PE-S treaty and thus, that the PE should be entitled to relief.

\textbf{4.3.4.1. Partnerships}

For the purposes of applying Article 24(3), the taxation imposed on the PE should be compared to the taxation imposed on a resident enterprise that has the same legal form as the enterprise to which the PE belongs.\textsuperscript{278} In the case of companies and individuals, this does not raise any particular issues regarding treaty entitlement; however, it may be somewhat more difficult in the case of partnerships.

\textsuperscript{277} It has been pointed out that if the PE state were concerned about upsetting the reciprocity of its treaties by providing equivalent relief to PEs, then it could have negotiated for a limitation to be included in the non-discrimination article of its treaty with the residence state (Friedhelm, J., “Discriminatory Tax Treatment…”). However, if a particular state holds the view that no such relief obligation exists on the basis of the wording of Article 24(3), then it seems unlikely that it would seek to negotiate any specific limitation in its treaties.

\textsuperscript{278} OECD Commentary on Article 24, para 35. See also: Vogel, K., Engelschalk, M., & Görl, M., \textit{Klaus Vogel on Double Tax Conventions...}, at p. 1315, (m.no. 125); Van Raad, K., \textit{Nondiscrimination…}, at pp. 135, 137.
In general, partnerships that are transparent for tax purposes are not themselves eligible for treaty benefits because they do not meet the criteria for residence. Instead, it is the partners in the partnership who must claim treaty benefits and the "residence state" will generally be the state where the partners are resident. If a PE belonging to a transparent partnership (formed in State R) is compared, for the purposes of Article 24(3), to a similarly transparent partnership which is established in the PE state but which has partners resident outside the PE state, then the hypothetical enterprise to which the PE is being compared would not be entitled to relief under the PE-S treaty. It follows that no such relief should be available to the PE. However, given that it is the partners themselves and not the partnership which is claiming treaty benefits, a better approach seems to be to compare the taxation of the PE to the taxation that would have been imposed on a partnership formed by residents of the PE state. Provided the partnership is treated as a transparent entity for tax purposes by all the states involved, then the partnership itself is effectively irrelevant for the purposes of applying Article 24(3). In this case, the partners in the partnership would presumably be entitled to relief under the PE-S treaty and consequently, such relief should also be extended to the PE.

More complicated is the situation where the PE state, the source state, and the state where the partnership is formed and/or where the partners are resident, do not tax the income of the partnership on the same basis; i.e., one or more states treat it as a separate taxable entity and one or more other states treat it as transparent and impose tax directly on the partners. Such hybrid entity situations are beyond the scope of this thesis, but it should be noted that in such situations it may be more difficult for the PE to demonstrate that it should be entitled to treaty relief in the PE state under Article 24(3) of the R-PE treaty and it is likely that in some cases, no relief will be available.

4.3.4.2 Limitation on benefits provisions

A Limitation on Benefits (LOB) article restricts the availability of treaty benefits by providing that such benefits are only available if certain conditions are satisfied. The existence of an LOB provision in the PE-S treaty makes determining whether treaty relief should be available to the PE under Article 24(3) of the R-PE treaty more complicated because where there is an LOB provision, determining whether treaty benefits would be available to the comparison entity requires a much more in-depth consideration of the structure, activities and circumstances of that comparison entity.

LOB articles are contained in virtually all the treaties concluded by the United States and the United States is one of the contracting states in the majority of treaties containing an LOB article. Keeping this in mind, the following discussion will focus on the LOB article contained in the 2006 US Model Convention. The Commentary to the OECD Model Convention also contains suggested wording for an LOB provision, which may form the basis for LOB provisions included in tax treaties, and which will also be referred to below. Many of the provisions of the OECD Commentary's LOB are similar to those of the US Model LOB provision.

279 2010 OECD Commentary on Article 1, para 5. See also: Vogel, K., Engelschalk, M., & Görl, M., Klaus Vogel on Double Tax Conventions..., at p. 1313, (m.no. 121). This assumes that all the states involved treat the partnership in the same way; for discussion of situations where this is not the case, see: Barenfeld, J., Taxation of Cross-Border Partnerships: Double Tax Relief in Hybrid and Reverse Hybrid Situations, Doctoral Series, Vol. 9, (Amsterdam: IBFD, 2005); OECD, “The Application of the OECD Model Convention to Partnerships: Issues in International Taxation No. 6” (Paris: OECD, 1999) (commonly referred to as the “Partnership Report”).

280 2010 OECD Commentary on Article 1, para 5. See also: Vogel, K., Engelschalk, M., & Görl, M., Klaus Vogel on Double Tax Conventions..., at p. 1313, (m.no. 121).

281 Vogel, K., Engelschalk, M., & Görl, M., Klaus Vogel on Double Tax Conventions..., at p. 1313, (m.no. 121).

282 For discussion of hybrid entities, see: Barenfeld, J., Taxation of Cross-Border Partnerships.

283 With certain notable exceptions, including the treaty between the US and Poland and the treaty between the US and Hungary. (A new Hungary-US treaty containing an LOB was negotiated in 2010, but is not yet in force).

284 The US has around 46 treaties in force that contain an LOB. Other states with multiple treaties containing LOBs include, for example, Israel (22 treaties), India (18 treaties), Sweden (11 treaties), Germany (7 treaties), Mexico (7 treaties), Turkey (6 treaties), and Japan (5 treaties) [based on searches of IBFD’s tax treaty database in January 2012].

285 2010 OECD Commentary on Article 1, para 20.
Please note that this analysis is intended simply to highlight some of the issues associated with applying Article 24(3) when the treaty between the PE state and the source state contains an LOB article and does not seek to conduct an in-depth analysis of an LOB provision.

Active business test

The LOB article of the US Model Convention provides that the benefits under the convention will be available with respect to an item of income derived in connection with (or incidental to) the active conduct of a trade or business in the residence state (referred to herein as the "active trade or business test"). Consideration of the circumstances in which there may be a "trade or business", and in which income may be derived in connection with (or incidental to) that trade or business, are beyond the scope of this study. However, given the nature of a PE and the methods used to determine the income attributable to a PE, it is possible that the income derived by a PE will have been derived in connection with a trade or business carried on by the PE in the PE state.

If the income is derived in connection with the active conduct of a trade or business carried on by the PE, then it should also be considered to be derived in connection with the active conduct of a trade or business by the comparison entity. This is because the comparison entity must be considered to carry on the "same activities" as the PE. If the comparison entity satisfies the active trade or business test, then it should be (hypothetically) entitled to relief under the PE-S treaty and consequently, the PE should be entitled to equivalent relief under Article 24(3) of the R-PE treaty.

Stock exchange listing test

A company is a "qualified person," and thus not excluded from entitlement to treaty benefits under the US Model LOB, if the principal class of its shares is regularly traded on one or more recognized stock exchanges and either (a) its principal class of shares is traded on a recognized stock exchange in its residence state, or (b) its primary place of management and control is in its residence state. If the PE

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286 2006 US Model Convention, Article 22, para 3(a) reads: "A resident of a Contracting State will be entitled to benefits of the Convention with respect to an items of income derived from the other State, regardless of whether the resident is a qualified person, if the resident is engaged in the active conduct of a trade or business in the first-mentioned state (other than the business of making or managing investments for the residents' own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer), and the income derived from the other Contracting State is derived in connection with, or is incidental to, that trade or business."

287 The equivalent provision of the OECD Commentary's LOB provides that benefits will be available with respect to an item of income "if the resident is actively carrying on business" in its residence state and the income "is derived in connection with, or is incidental to, that business" (2010 OECD Commentary on Article 1, para 20, clause 3(a)). Given that the definition of a PE refers to "a fixed place of business through which the business of an enterprise is wholly or partly carried on" (2010 OECD Model, Article 5(1)) and that the income which is taxable in the PE state is the income which is "attributable" to the PE, it seems that the PE would generally be considered to be "actively carrying on business" and that its income would generally be considered to be derived in connection with that business. Therefore, the comparison entity could generally be expected to meet the requirements of the active business test contained in the OECD Commentary's LOB provision.

288 For a discussion of these issues in the US context, see: 2006 US Model Technical Explanation, pp. 69-72.

289 Or in connection with "actively carrying on a business," depending on the specific terms used in the LOB provision.

290 These are the primary tests, but there is also a test which looks at the ownership of the company by entities that meet the listing test (see the provision included in this footnote). 2006 US Model Convention, Article 22, para 2 reads: "A resident of a Contracting State shall be a qualified person for a taxable year if the resident is: ... (c) a company, if: (i) the principal class of its shares (and any disproportionate class of shares) is regularly traded on one or more recognized stock exchanges, and either: (A) its principle class of shares is traded on one or more recognized stock exchanges located in the Contracting State of which the company is resident; or (B) the company's primary place of management and control is in the Contracting State of which it is a resident; or (ii) at least 50% of the aggregate vote and value of the shares (and at least 50% of any disproportionate class of shares) in the company is owned directly or indirectly by five or fewer companies entitled to benefits under clause (i) of this sub-paragraph, provided that, in the case of indirect ownership, each intermediate owner is a resident of either Contracting State."
belongs to a company that is listed on a recognised stock exchange, it may be possible to apply the stock exchange listing test to the comparison entity.

A stock exchange listing does not fit neatly into the principle that the comparison entity should be considered to have the same legal form as the entity to which the PE belongs, since it is not a legal characteristic of the entity. It also does not fall within the "same activities" requirement of Article 24(3), since it is highly unlikely that the activities associated with listing on the stock exchange (e.g., investor relations, compliance with listing rules) would be carried out by the PE. The listing is, however, part of the circumstances surrounding the PE and the key question is therefore whether there is an implied "same circumstances" test in Article 24(3) and, if there is, how it should be applied.

Article 24(3) does not expressly require that the taxation of the PE be compared to a resident enterprise that is in the same circumstances. This is in contrast to Article 24(1), which deals with discrimination on the basis of nationality. Van Raad argues that, because Article 24(3) is not considered to be limited to prohibiting rules that differentiate based on activities, the circumstances which must be kept the same for determining whether there has been discrimination are not restricted to the activities conducted by the PE and thus, that there is an implied same circumstances test.292 Adonnino dismisses this argument, but notes that it is important that that the PE and the resident enterprise are comparable.

Even if there is an implied same circumstances requirement in Article 24(3), it is not clear exactly what the circumstances of the comparison entity should be with respect to a stock exchange listing. That is, whether the taxation of the PE should be compared to a hypothetical entity that is itself listed, or alternatively, whether it should be compared to a hypothetical subsidiary of the listed company to which the PE belongs. In general, the taxation imposed on the PE must be compared to the taxation imposed on a purely domestic enterprise of the PE state; it should not be compared to a domestic subsidiary controlled by a foreign company. The appropriate comparison therefore seems to be to an entity which is itself listed rather than to a subsidiary of the listed entity to which the PE belongs. If the taxation of the PE is compared to a listed company resident in the PE state, the next question is on which stock exchange the hypothetical comparison entity should be considered to be listed, and where its place of management should be considered to be located. It is submitted that the comparison entity should be considered to be listed on the same stock exchange as the entity to which the PE belongs. There seems to be no basis for making an assumption that the comparison entity is listed in the PE state. It follows that unless the entity to which the PE belongs is listed in the PE state (or the source state – both of which seem relatively unlikely), then even if there is an implied same circumstances test, the comparison entity should not be considered to meet the stock exchange listing test on the basis of being listed in its residence state.

Determining the place of management and control of the comparison entity may also be difficult. Prima facie, it would appear that the place of management and control of the PE should coincide with the place of management and control of the entity to which it belongs, generally the residence state. However, if the PE is completely autonomous from an operational perspective, then it is possible that the
management and control of the PE (and thus the comparison entity, on the basis that it carries on the same activities as the PE) should be considered to be located in the PE state. Another alternative, if the residence rules of the PE state are based solely upon the place of management, is that the entity would be considered to be managed in the PE state on the basis that it would otherwise not be a "resident enterprise" as required by Article 24(3).

In general, it seems that it would be very difficult, if not impossible, to demonstrate that a PE should be entitled to treaty relief on the basis that the comparison entity satisfies the listing test. This would require firstly that Article 24(3) contains an implied same circumstances requirement, and secondly, that the comparison entity is considered to meet the listing test, either by being listed on an exchange in the PE state or by being managed and controlled in the PE state.

**Ownership and base erosion test**

The ownership and base erosion test requires (i) that on at least half the days in the taxable year, qualified residents of the entity's residence state own at least 50% of the aggregate voting power in the entity (the "ownership test"), and (ii) that less than 50% of the entity's gross income is paid or accrued to persons who are not resident in either of the contracting states in the form of payments that are deductible (excluding arm's length payments in the ordinary course of business for services or tangible property) (the "base erosion test"). Both these requirements must be met in order for the benefits of the treaty to be available under this paragraph of the LOB provision. The equivalent provisions of the OECD Commentary LOB are very similar.

Whether the comparison entity meets the ownership test will depend upon the hypothesised ownership structure of that entity. If the PE is compared to an entity which is a subsidiary of the entity to which the PE belongs, then the test will clearly not be met; however, this is not generally considered to be the appropriate comparison. Alternatively, if the PE is compared to an entity which is owned by residents of the PE state, as suggested by Vogel, then the ownership test generally would be met. Another possible approach is to consider a comparison entity which has the same ownership structure as the entity to which the PE belongs; in this case, the ownership test could only be met if the entity to which the PE belongs is more than 50% owned by residents of the PE state, which is possible but seems an unlikely scenario.

The application of the base erosion test to the comparison entity should be relatively straightforward. For determining whether the base erosion test is satisfied, any payments deducted in calculating the profit attributable to the PE (other than arm's length payments in the ordinary course of business) should, prima facie, be considered to be base eroding payments and should be compared to the gross income attributable to the PE to determine whether the base erosion test is met. However, even where the comparison entity does satisfy the base erosion test, it will only be entitled to relief under the PE-S treaty if it also meets the ownership test which, as discussed above, is likely to be difficult.

**Conclusion**

If the treaty between the PE state and the source state contains an LOB provision, then it will be very difficult to determine whether the comparison entity would be entitled to treaty relief, and thus, whether the PE should be entitled to equivalent relief under the Article 24(3) of the R-PE treaty. Such relief will only be available if the comparison entity satisfies one of the tests discussed above. Of these, the active business test may potentially be satisfied, depending on the circumstances, but in most cases it would generally not be possible to satisfy any of the other tests. The application of these tests is made considerably more difficult in the context of applying Article 24(3) than in the case of a direct application

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298 2006 US Model Convention, Article 22, para 2(e).
299 OECD Commentary on Article 1, para 20, clause 2(e).
300 Vogel, K., Engelschalk, M., & Görl, M., *Klaus Vogel on Double Tax Conventions...*, at pp. 1314-5, (m.no. 123).
301 Vogel, K., Engelschalk, M., & Görl, M., *Klaus Vogel on Double Tax Conventions...*, at pp. 1314-5, (m.no. 123).
302 See, for example, the discussion in: Vogel, K., Engelschalk, M., & Görl, M., *Klaus Vogel on Double Tax Conventions...*, at p. 1314, (m.no. 122).
to a resident enterprise by the need to determine the appropriate characteristics to attribute to the
hypothetical comparison entity. Therefore, where the PE-S treaty contains an LOB provision, the PE is
unlikely to be able to claim relief for tax imposed in the source state on the basis of the non-
discrimination article of the R-PE treaty.

4.3.5. Amount of credit relief

If the PE state grants relief for tax imposed in the source state on the basis of domestic law, then it seems
quite clear that the credit available in the PE state should be subject to any limitations contained in that
domestic law. In most cases, the credit is likely to be the lesser of (i) the tax actually imposed on the
income in the source state and (ii) the tax attributable to the income in the PE state. However, the
appropriate limitations to apply to the amount of the credit are not quite so clear when treaty relief is
being extended to the PE. This is particularly relevant in triangular cases involving dividends and interest
(and potentially also royalties304) if the rate of source-based taxation which would be allowed under the
PE-S treaty differs from the rate actually imposed in the source state.

The OECD Commentary suggests that where the PE state extends treaty relief to PEs using the credit
method, the amount of the credit should be the lesser of (i) the amount of tax actually imposed in the
source state and (ii) the amount of tax that could have been imposed in the source state if the treaty
between the source state and the PE state had applied. The credit is of course also limited to the
amount of tax attributable to the income in the PE state. The two limitations suggested by the OECD
will be discussed in turn below. It will be assumed for the purposes of discussion that the tax attributable
to the income in the PE state exceeds both these limitations, such that the limitation based on the amount
tax in the PE state is not relevant.

4.3.5.1. The first limitation: Tax imposed in the source state

The first limitation, which limits the credit to the amount of tax imposed in the source state, will be
relevant in situations where the amount of tax actually imposed in the source state is lower than the
amount it could impose if it applied the terms of the PE-S treaty. It would be relevant, for example, in a
situation where the source state imposes withholding tax of 10% on, e.g., interest, under its domestic law
and in accordance with the R-S treaty, while the maximum rate allowed under the PE-S treaty is 15%.

One of the basic principles of foreign tax credit relief is that the credit should not exceed the amount of
foreign tax paid. For the purposes of applying Article 24(3), however, it is the tax burden imposed on the
PE’s income in the PE state which must be considered and which must be compared to the tax burden
imposed on a resident enterprise; the means by which the tax is imposed is irrelevant. It follows from
this that the principles applied to resident taxpayers do not have to be applied to the PE under Article
24(3) and if Article 24(3) is being applied to determine the amount of the credit that should be available, it
is the result which must be compared and not the specific rules and principles that are applied. What
seems like an obvious limitation on the credit available in the PE state depends, in fact, on the
comparison which is made for the purposes of Article 24(3).

If the PE is compared to a resident enterprise earning the same income as the PE from the source state,
then the amount of credit should be equal to the amount of the credit that would be available to that
resident enterprise. If the income attributable to the PE were derived by a resident of the PE state, then
the amount of tax imposed in the source state would be the lower of (i) the amount it may impose under

303 There may also be other limitations applicable under domestic law, such as a country-by-country limitation or a
basket system (see Chapter 3 (Section 3.2.3.1.) for a discussion of various credit limitations in the context of the
residence state).
304 The OECD Model does not provide for any source based taxation of royalties under Article 12, however, many
concluded treaties do allow for limited source-based taxation.
305 OECD Commentary on Article 24, para 70, which goes on to suggest specific wording to achieve this outcome.
See also: OECD Committee on Fiscal Affairs, "Triangular Cases", para. 49.
306 Van Raad, K., "The 1992 OECD Model…"
307 OECD Commentary on Article 24, para 34.
the PE-S treaty and (ii) the amount it would impose under domestic law in the absence of any limitation. Thus, if the correct comparison is to an entity paying the same amount of tax in the source state as a resident of the PE state would pay, then there is no technical basis for limiting the credit available to the PE to the amount of tax actually imposed in the source state. This is demonstrated in the following example.

**Example**

In a PE triangular case, the income attributable to the PE includes $100 of income from sources in State S. The PE does not earn any other income and has no expenses. The domestic withholding tax rate in the source state is 20%, but the rate of tax the source state may impose is limited to 10% under the R-S treaty. The source state therefore imposes $10 of tax. The PE state imposes $20 of tax on the income and does not provide any double taxation relief under its domestic law. The residence state exempts the income attributable to the PE. If the income had been derived by a resident of the PE state then, under the PE-S treaty, the tax imposed in the source state would have been limited to 15% of the gross amount of the income and the PE state would have been obliged to provide relief using the credit method. The PE state extends treaty relief to the PE under Article 24(3) of the R-PE treaty. The relief is limited to either:

1. The lesser of the amount of tax that could be imposed in the source state if it applied the PE-S treaty and the amount of tax actually imposed in the source state; and
2. The amount of tax that could be imposed in the source state if it applied the PE-S treaty (but not limited to the amount of tax actually imposed in the source state).

This situation is illustrated in the following diagram.

*Figure 4.1.*: Example demonstrating impact of credit limitations in the PE state

The following table illustrates the different outcomes that may arise if the credit is, or is not, limited to the amount of tax imposed in the source state.

*Table 1: Example demonstrating different outcomes that may arise if credit in PE state is or is not limited to the amount of tax imposed in the source state*

<table>
<thead>
<tr>
<th></th>
<th>Comparison - Income derived by resident of PE State</th>
<th>(i) Relief limited to tax imposed in the source state</th>
<th>(ii) Relief not limited to tax imposed in the source state</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Tax imposed in source state</td>
<td>15</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Tax imposed in the PE state prior to relief</td>
<td>20</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>Relief available</td>
<td>15</td>
<td>10</td>
<td>15</td>
</tr>
<tr>
<td>Tax imposed in the PE state</td>
<td>5</td>
<td>10</td>
<td>5</td>
</tr>
</tbody>
</table>
This table demonstrates that if the PE is compared to a resident enterprise which is (i) earning the same income as the PE from sources in the source state and (ii) paying the same amount of tax in the source state that a resident of the PE state would pay, and the relief available to the PE is limited to the amount of tax actually imposed in the source state, then the amount of tax imposed in the PE state ($10) will be greater than that imposed on the comparable resident enterprise ($5). If this limitation did not apply and the credit in the PE state was instead only limited to the tax that could be imposed by the source state if the PE-S treaty applied, then the PE state would impose the same amount of tax on the PE as would be imposed on a resident enterprise (i.e., $5). However, this also demonstrates a significant problem with not applying a limitation based on the amount of tax effectively imposed in the source state, namely, that the PE state may be required to grant a credit for tax which was not actually paid.

In order for this limitation to apply, the PE would have to be compared to a resident enterprise earning the same income as the PE and paying the same amount of tax in the source state as was paid by the PE. That is, the payment of a certain amount of tax in the source state would have to be considered an aspect of carrying on the "same activities" as the PE. It is difficult to accept this view. If this is the right approach, however, then to continue the example above, the resident enterprise to which the PE is being compared would be considered to have paid $10 of tax in the source state and would be entitled to a credit of only $10, resulting in a tax liability in the PE state of $10.

4.3.5.2. The second limitation: Tax that could be imposed in the source state if the PE-S treaty applied

The second limitation, based on the tax which could be imposed under the PE-S treaty, will be relevant where the tax imposed in the source state is higher than it could have imposed if the PE-S treaty had applied. So, for example, it would be relevant if the R-S treaty provides for a maximum rate of source-based taxation of 15% and the PE-S treaty provides for a maximum rate of 10%.

The second limitation compares the taxation imposed on the PE to the taxation that would be imposed on a resident enterprise earning the same income as the PE from the same sources. Unlike in the previous limitation, this limitation considers what the outcome would be in the source state (and the credit that would be required) if the income were derived by a resident enterprise of the PE state. It is thus based on the comparison entity paying the same amount of tax in the source state as a resident of the PE state would pay, taking into account the application of the PE-S treaty. This is demonstrated in the following example.

Example

In a PE triangular case, the income attributable to the PE includes $100 of income from sources in State S. The PE does not earn any other income and has no expenses. Under the R-S treaty the source state may impose tax on the income, but the tax may not exceed 15% of the gross amount of the income. The source state imposes $15 of tax. The PE state, prior to any relief from double taxation, imposes tax of $20 on the income. The PE state does not provide any double taxation relief under its domestic law. If the income had been derived by a resident of the PE state then, under the PE-S treaty, the tax imposed in the source state would have been limited to 10% of the gross amount of the income and the PE state would have been obliged to provide relief from double taxation using the credit method. Under Article 24(3) of the R-PE treaty, the PE state extends treaty relief to the PE. The relief is limited to either:

(i) the lesser of the tax imposed in the source state and the amount of tax that could be imposed in the source state if it applied the conditions of the PE-S treaty; or

(ii) the tax imposed in the source state (i.e., the relief is not limited to the amount of tax that could be imposed if the source state applied the conditions of the PE-S treaty).

This situation is illustrated in the following diagram, and the two alternatives are shown in the table below.
Figure 4.2: Example showing the impact of limiting relief in the PE state to the amount of tax the source state could impose if it applied the PE-S treaty

Table 2: Example illustrating the potential outcome where relief (i) is and (ii) is not limited to the amount of tax the source state could impose if it applied the conditions of the PE-S treaty

<table>
<thead>
<tr>
<th></th>
<th>Comparison – resident of PE State</th>
<th>(i) Relief limited to amount that could be imposed under PE-S treaty</th>
<th>(ii) Relief not limited to amount that could be imposed under PE-S treaty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Tax imposed in source state</td>
<td>10</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>Tax imposed in the PE state prior to relief</td>
<td>20</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>Relief available</td>
<td>10</td>
<td>10</td>
<td>15</td>
</tr>
<tr>
<td>Tax imposed in the PE state</td>
<td>10</td>
<td>10</td>
<td>5</td>
</tr>
</tbody>
</table>

This table demonstrates that limiting the amount of relief available to the PE to the amount of tax that could be imposed in the source state under the PE-S treaty if it applied (see (i) in the table above), means that the PE pays the same amount of tax in the PE state as a resident enterprise would pay (i.e., $10). One potential problem with this limitation is that the PE is not granted sufficient relief to fully compensate for the tax it pays in the source state and thus to prevent double taxation. In the example above, the comparison entity bears an overall tax burden of $20, while the PE bears an overall tax burden of $25. This should not, however, prevent this limitation from being applied because Article 24(3) only requires the taxation in the PE state to be considered; the PE state is not required to compensate for less favourable treatment in a third state (i.e., the source state). If this limitation is not applied (see (ii) in the table above), then the PE state may end up collecting less tax than it would collect if the income were earned by a resident of the PE state. In the example above, for instance, the PE state collects $5 while it would have collected $10 from a comparable resident enterprise.

308 Article 24(3), OECD Model: "The taxation on a permanent establishment which an enterprise of a Contracting State [State R] has in the other Contracting State [State PE] shall not be less favourably levied in that other State [State PE]..." [emphasis added]. See also: Avery Jones, J.F., et al., "The Non-discrimination Article...."

4.3.5.3. Inconsistency between the limitations

While the two limitations discussed above do seem reasonable from a practical perspective, the logic behind them is not entirely consistent in terms of what is being compared to determine whether the taxation on the PE is less favourable than that which would be imposed on a resident enterprise carrying on the same activities. The first limitation effectively compares the PE to a resident enterprise that paid the same amount of tax in the source state as was actually paid by the PE. The second limitation, on the other hand, effectively considers how much tax a resident of the PE state would pay in State S (taking into account the conditions of the PE-S treaty). This means that applying both limitations requires a differing comparison depending upon the rate of tax imposed in the source state relative to the amount of tax that could have been imposed if the PE-S treaty applied. From a technical perspective, the comparison should arguably be consistent regardless of the applicable rate under the PE-S treaty, however, applying a consistent comparison would mean that only one of the two limitations could apply.

4.3.5.4. Appropriate limitation to apply

It is difficult to determine which limitation is more appropriate from a theoretical perspective, although arguably it would be the limitation based on the rate applicable under the PE-S treaty, since this will result in the PE paying the same amount of tax in the PE state as a resident enterprise would pay. Applying either of the suggested limitations to the exclusion of the other is problematic. If the first limitation is not applied, then the PE state may be required to allow relief in excess of the amount of tax actually imposed in the source state. If the second limitation is not applied then, as mentioned above, the PE state may collect less tax than it would be able to collect if the income were earned by a resident enterprise of the PE state. Clearly neither of these outcomes would be acceptable to the PE state, although on balance, most states would probably be more averse to granting a credit where no tax has been imposed, given the opportunities this would present for tax avoidance. Since it is not appropriate to apply either one of these two limitations in isolation, and given the inconsistency inherent in applying both under the current wording of Article 24(3), it would be highly desirable for tax treaties to include specific wording establishing the applicable limitations. As mentioned above, this is the approach taken in the suggested wording contained in the OECD Commentary.310 Specific wording requiring the PE state to grant relief would also have the significant advantage of forestalling any questions regarding whether the PE state actually has an obligation to extend treaty relief to PEs under Article 24(3) of the R-PE treaty.

4.3.6. Relief in sub-PE triangular cases

In sub-PE triangular cases the income in question is attributable to both the PE and the sub-PE and the sub-PE state effectively operates as the source state with respect to the PE state. This may occur, for example, where there is a regional headquarters in the PE state and a local operation in the sub-PE state. It seems clear that in this case the PE state should provide relief for tax imposed in the sub-PE state and indeed, the PE state would generally have an obligation to provide relief under the non-discrimination article of the R-PE treaty as discussed above. The complication in sub-PE triangular cases is that a PE also exists for the purposes of the R-SPE treaty (the sub-PE) and the income attributable to that sub-PE is also taxable in another state on a source basis (i.e., in the PE state). If a resident of the sub-PE state derived the income which is attributable to the sub-PE then it would typically be entitled to relief for tax imposed in the PE state. It therefore seems likely that the sub-PE state would also have an obligation to provide relief under the non-discrimination provision of the R-SPE treaty. This doesn’t present any

310 OECD Commentary on Article 24, para 70. The suggested provision is as follows: "When a permanent establishment in a Contracting State of an enterprise of the other Contracting State receives dividends or interest from a third State and the holding or debt-claim in respect of which the dividends or interest are paid is effectively connected with that permanent establishment, the first-mentioned State shall grant a tax credit in respect of the tax paid in the third State on the dividends or interest, as the case may be, by applying the rate of tax provided in the convention with respect to taxes on income and capital between the State of which the enterprise is a resident and the third State. However, the amount of the credit shall not exceed the amount that an enterprise that is a resident of the first-mentioned State can claim under that State’s convention on income and capital with the third State."
particular issues if viewed in isolation, however, the provision of relief in both the sub-PE state and the PE state is clearly problematic. If both states use the exemption method then presumably the income would not be taxed in either state which would tend to give rise to opportunities for tax avoidance. If both states use the credit method then the credit available in each state depends on the tax imposed in the other state and thus the credit available in the other state; this quickly becomes circular and it is not clear how the final credit should be calculated. The only case in which problems don’t arise is where one state to use the credit method and the other state uses the exemption method. Problems arise in sub-PE triangular cases with respect to the relief provided to PEs regardless of whether such relief arises from non-discrimination principles or under domestic laws and these problems should be dealt with in any solution for PE triangular cases.

4.3.7. Comparison between Article 24(3) and non-discrimination principles of EU law

In the *Saint-Gobain* case, the ECJ decided that under the non-discrimination principles of European law, the PE state in a PE triangular case is obliged to extend both the domestic double taxation relief measures and the treaty relief measures available to resident enterprises to PEs.

The *Saint-Gobain* case involved a PE established in Germany by a French company. The income attributable to the PE included dividends received from companies located in various source states, which were fully taxable in Germany. Under the tax treaties between Germany and two of the source states, the United States and Switzerland, dividends received by residents of Germany from those states were exempt in Germany. The taxpayer in *Saint-Gobain* claimed that, in order to comply with the freedom of establishment provisions of the EU treaty, these exemptions should also have been granted to the PE.

The *Saint-Gobain* case was based on the freedom of establishment contained in Articles 49 and 54 (then, Articles 52 and 58, respectively) of the EC Treaty. The scope and purpose of these non-

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312 The *Saint-Gobain* case involved a request for three tax concessions with respect to the dividends received: (1) an exemption from the German corporation tax for dividends received from companies resident in the US and Switzerland which was available to German resident companies under the treaties concluded between Germany and those states; (2) an indirect tax credit for taxes imposed on the profits from which foreign dividends were paid which was available to German resident companies under German domestic law; and (3) A capital tax concession available to German resident companies under German domestic law (ECJ, 21 September 1999, *Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt*, C-307/97, paras 16-22.
314 ECJ, 21 September 1999, *Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt*, C-307/97, paras 15-18. The company also claimed an indirect credit and a capital tax concession, but these claims are not relevant for the analysis here.
315 Articles 49 and 54 (then, Articles 52 and 58, respectively) of the Treaty on the Functioning of the European Union (then, the EC treaty).
316 ECJ, 21 September 1999, *Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt*, C-307/97, paras 15-18. The company also claimed an indirect credit and a capital tax concession, but these claims are not relevant for the analysis here.
317 Article 49, titled "Right of Establishment" reads: "Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting up of agencies, branches, or subsidiaries by nationals of any Member State established in the territory of any Member State. Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital."
318 Article 54 reads: "Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States. 'Companies or firms' means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit making."
319 Now called the Treaty on the Functioning of the European Union (TFEU).
The discrimination principles of EU law are very different to those of Article 24(3) of the OECD Model, which means that the ECJ case law should not be directly applied to the interpretation of Article 24(3). 320 The intention of both provisions is to promote international trade and investment, however, the EU law provisions have the much broader aim of achieving a European Single Market, whereas the various provisions of Article 24(3) are very specific, aimed at preventing discrimination in certain defined circumstances. 321 Nevertheless, there may still be certain aspects of the analysis of the non-discrimination principles of EU law in the Saint-Gobain case which are relevant for the interpretation of Article 24(3) in PE triangular cases.

The first step in applying the freedom of establishment in the Saint-Gobain case was to determine that the PE was in an objectively comparable situation to that of a resident taxpayer. 322 In this respect, the German government argued that a non-resident deriving income through a PE and a resident enterprise are not in an objectively comparable situation because the non-resident is subject to only a limited tax liability, i.e., it is only taxed on income which is attributable to the PE, whereas a resident is subject to an unlimited tax liability. 323 The ECJ rejected this argument on the basis that the dividends were taxed in Germany regardless of whether they were derived by a resident taxpayer or by a non-resident through a PE, and on the basis that the only difference in the tax treatment arose with respect to the tax concessions in question. 324 For the purposes of applying Article 24(3), on the other hand, it is not necessary to establish that the PE is in a comparable situation to a resident of the PE state. This is because Article 24(3) specifically provides that the tax imposed on a PE must not be less favourable than that imposed on a resident enterprise carrying on the same activities. It does not require any preliminary consideration of whether a resident enterprise and a PE of a non-resident are in a comparable situation, 325 which could mean that less favourable tax treatment of PEs is prohibited even if the situation of the PE is not objectively comparable to that of a resident enterprise.

The German government argued in the Saint-Gobain case that not granting relief to PEs was justified by the need to prevent a reduction in tax revenue and that, unlike in the case of resident companies, which were taxed on dividend distributions, the lost revenue could not be made up by imposing tax on profits distributed by the PE. 326 This was not regarded as sufficient justification for the unequal treatment. 327 Similarly, for the purposes of the application of Article 24(3), a potential loss of tax revenue should not be a sufficient justification for taxing a PE less favourably than a resident enterprise; if it were, then the PE state would arguably never be required to do anything under Article 24(3) because where Article 24(3) operates, it will always reduce the tax imposed in the PE state. 328 However, an important difference between Article 24(3) and the EU non-discrimination principles discussed in Saint-Gobain is that Article 24(3) considers the overall tax burden imposed in the PE state and does not require that the PE is taxed in the same way as a resident enterprise. 329 Thus, if the PE is given other advantages under the tax laws of the PE state that outweigh the disadvantage of the lack of double taxation relief, then, provided the overall tax burden imposed on the PE in the PE state is not less favourable than that which would be imposed on a resident enterprise, there should be no contravention of Article 24(3) of the R-PE treaty. 330

The specific compensating aspect of the German tax law which was referred to in the Saint-Gobain case was that the withholding tax imposed on dividends paid by a subsidiary to its parent company could not be imposed on the distribution of profits by the PE, given that a PE is merely part of the entity to which it belongs and is not a separate legal entity. 331 As mentioned above, the ECJ did not consider this
sufficient justification for failing to grant relief to the PE. The lack of withholding tax on distributions by a PE should also not be considered sufficient justification for denying double taxation relief under Article 24(3). Dividend withholding tax, while it may be collected from the company paying the dividend, is generally a tax imposed on the recipient of the income and is therefore not relevant for determining whether the tax imposed on the income attributable to a PE is more burdensome than that imposed on the income of a resident enterprise. Nevertheless, it is at least theoretically possible for there to be some aspect of the domestic law of the PE state which has the effect that the taxation imposed on the PE in the PE state is not less favourable than that imposed on a resident enterprise carrying on the same activities, despite the lack of any double taxation relief available to the PE.

Another important justification which was presented in the Saint-Gobain case was that extending the relief available under the treaties with the source states to PEs in Germany would upset the balance and reciprocity of those treaties. As was discussed above, this argument was rejected by the ECJ and should also be rejected in the context of Article 24(3).

One important difference between the principles of EU law and Article 24(3) is that, where all three of the states involved in a PE triangular situation are EU member states, EU law may also require the source state to apply the conditions of the PE-S treaty to the income attributable to the PE. This debate is beyond the scope of this thesis but it should be noted that, in contrast to EU law, Article 24(3) of the treaty between the residence state and the PE state will never have any impact on the source state.

Taxation in the source state in PE triangular cases will be discussed in the following chapter (Chapter 5).

4.4. Conclusions

Where the income attributable to a PE includes income sourced in third states, the PE should clearly be entitled to relief from double taxation in the PE state. Such relief ensures that double taxation can be fully relieved in PE triangular cases without the residence state reducing the tax it collects in relation to other sources of income, and thus ensures a more equitable distribution of taxing revenues between the PE state and the residence state. Various states allow double taxation relief to PEs under their domestic law, however, this is not always the case and even where it is, the relief available to resident taxpayers may be more favourable than that available to PEs. It is therefore important to consider the operation of the PE non-discrimination article (Article 24(3)) of the treaty between the residence state and the PE state.

Under Article 24(3) of the R-PE treaty, the PE state should be obliged to extend its domestic relief measures to PEs as well as relief equivalent to that which would be available to a resident of the PE state under the treaty between the PE state and the source state. In practice, however, states do not always consider themselves bound by this obligation to provide relief. Moreover, the extension of treaty relief to PEs under non-discrimination principles may result in an unbalanced application of the PE-S treaty, given that the source state is not required to apply the conditions of that treaty in relation to the income attributable to the PE.

It would therefore be desirable for the PE state to have an explicit obligation to provide relief for tax imposed in the source state in PE triangular cases. Such a provision should also specify, in cases where the PE state uses the credit method of relief, the applicable limitations on the amount of relief to be provided. Similarly, if the exemption method applies, it should be made clear that the PE state is not required to exempt the income if the source state is prevented from imposing tax under the R-S treaty. A provision requiring the PE state to grant relief for tax imposed in the source state could take a number of forms, and will be discussed further in Chapter 7.

332 Vogel, K., Engelschalk, M., & Görl, M., *Klaus Vogel on Double Tax Conventions*, at p. 1317, (m.no. 128).
334 For discussion of this issue, see, for example: Kostense, H.E., "The Saint-Gobain Case...", Martín Jiménez, A.J., García Prats, F.J., & Calderón Carrero, J.M., "Triangular Cases...."
335 It will be discussed again briefly in Chapter 5 (see Section 5.2.7).