Triangular cases: The application of bilateral tax treaties in multilateral situations
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Chapter 9

Further issues regarding treaty entitlement for PEs

9.1. Introduction

This chapter addresses certain additional issues which may arise if the PE-S treaty is made to apply in PE triangular cases. These are largely issues which arise with respect to the application of certain articles of the PE-S treaty, but special considerations for PEs of insurance companies and in sub-PE triangular cases are also addressed. The second part of this chapter goes on to discuss the scope of the extension of treaty benefits to PEs. It discusses the extent to which the PE should be able to claim treaty benefits under the R-PE treaty, and whether notional payments should be recognised for treaty purposes beyond the determination of attributable income.

While this chapter seeks to identify and deal with some of the more important questions which may arise in extending treaty benefits to PEs, it does not purport to be exhaustive and can only deal briefly with each of the issues identified. If treaty benefits were in fact extended to PEs, there would undoubtedly be many more issues requiring serious consideration and both those issues and the issues identified in this chapter would clearly need to be considered in much greater depth and ideally discussed at a multilateral level.

It should also be remembered that, in accordance with the proposed provisions outlined in Chapter 8, the claim for treaty benefits under the PE-S treaty in relation to the income attributable to the PE would in fact be made by the entity to which the PE belongs, and not the PE itself. Nevertheless, for ease of expression, this chapter will generally refer to treaty benefits being extended to or claimed by PEs.

9.2. Special issues in applying the articles of the PE-S treaty

The application of the PE-S treaty in PE triangular cases would, in most circumstances, give rise to no specific issues in the application of the distributive rules of tax treaties that follow the OECD Model. The source state will simply ensure that the amount of tax it collects in relation to the income is in accordance with the terms of the PE-S treaty and, if necessary, the PE state will grant either exemption or credit relief for the tax imposed in the source state. Nevertheless, issues will arise with the application of certain treaty articles which may need to be specifically addressed.

9.2.1. Disagreements regarding the existence of a PE or attribution of income

It was concluded in Chapter 8 that, for the purposes of determining whether there is a treaty-eligible PE in the PE state under the PE-S treaty, the PE definition contained in the R-PE treaty should apply. However, even where all three states and the taxpayer are applying the same definition to a given set of facts, there may still be disagreement regarding whether a PE exists or whether certain income is attributable to a PE, particularly in borderline cases. The question arises, therefore, as to how such disagreements should be resolved. Where there is a disagreement as to the application of a treaty a bilateral situation, the taxpayer has the option of commencing the mutual agreement procedure (sometimes referred to as the "MAP"), and this should generally also be the case in multilateral situations. However, as will be seen below, the operation and effectiveness of the MAP may be subject to additional limitations in a multilateral situation.

This section will first briefly discuss the application of the mutual agreement procedure in bilateral situations, before going on to discuss the potential operation of mutual agreement procedures in multilateral situations where PEs are entitled to treaty benefits. This section will not discuss the opportunities which may be available to the taxpayer to raise objections under the domestic laws of the states involved, which would of course depend on the laws of those states.

1007 See Section 8.2.2.
9.2.1.1. Bilateral mutual agreement procedure

The MAP provision, Article 25, provides for agreements regarding the application of the treaty to specific taxpayers and more general agreements regarding the interpretation of the treaty. The discussion here will focus on the MAP procedure with respect to specific taxpayers under paragraphs 1 and 2 of Article 25.

Article 25(1) provides that:

"Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the State of which he is resident... The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention."

Article 25(2) provides that:

"The competent authority shall endeavour, if the objection appears to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States."

A taxpayer may invoke the mutual agreement procedure under Article 25, where, for example, the two states involved and/or the taxpayer come to different conclusions in a particular case regarding the existence of a PE and/or the attribution of income to a PE. In practice, the taxpayer will only invoke the mutual agreement procedure if one or both of the states' application of the treaty results in an unfavourable tax outcome for the taxpayer, e.g., where one state takes the view that certain income is taxable on the basis that it is attributable to a local PE, while the other state does not consider the income to be attributable to a PE and thus does not provide any relief. The taxpayer may also initiate the mutual agreement procedure in situations where there is no unrelieved double taxation, e.g., where both states consider the income to be attributable to a PE but the taxpayer disagrees, since this could also result in tax being imposed that is not in accordance with the terms of the convention.

A taxpayer seeking to invoke the MAP must present their request to the tax authorities of their residence state, regardless of which state has taken the action which has prompted the request. The request to initiate the mutual agreement procedure must be presented to the tax authorities within three years of the earliest notification of the action by the tax authorities, but may also be presented earlier if the taxpayer has reason to believe that the unfavourable outcome will occur, i.e., before any charge to tax. A taxpayer can also initiate the MAP whilst simultaneously pursuing domestic law remedies in relation to the same issue.

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1008 OECD Commentary on Article 25, para. 9.
1009 OECD Commentary on Article 25, para. 13.
1010 This may also lead to excess tax being imposed than if the treaty were properly applied, e.g., where the PE state's tax rate is higher than the residence state's tax rate, and the residence state uses the exemption method of relief.
1011 Unless the issue arises under Article 24(4), i.e., discrimination on the basis of nationality, in which case they submit their request to the state of which they are a national (Article 25(1)). Note that this proviso is omitted from the quotation set out above.
1012 OECD Commentary on Article 25, para 17. The OECD Commentary on Article 25 also states that the "Contracting States may, if they consider it preferable, give taxpayers the option of presenting their cases to the competent authority of either state" and gives alternative wording which could be included in the treaty to this effect (OECD Commentary on Article 25, para 19).
1013 The OECD Commentary on Article 25 states that the starting point for the time limit, "the 'first notification of the action resulting in taxation not in accordance with the provisions of the Convention' should be interpreted in the way most favourable to the taxpayer" (para 21). See also paras 22-25.
1014 OECD Commentary on Article 25, para 14.
1015 Holmes, K., *International Tax Policy and Double Tax Treaties*, (Amsterdam: IBFD, 2007), at p. 398 (Chapter 20); OECD Commentary on Article 25, paras 33-35. For the interaction between domestic proceedings and the mutual agreement procedure, see also: OECD Commentary on Article 25, paras 42-45.
Once the MAP is initiated, the competent authorities of the contracting states (generally the tax authorities) must "endeavour" to resolve the issue; there is no requirement that they actually come to a conclusion.\textsuperscript{1016} This aspect of the MAP has been widely criticised, as has the excessive time which it may take for the competent authorities to reach an agreement regarding the application of the treaty. In more recent treaties, however, this deficiency may be counteracted by the inclusion of an arbitration provision, which was introduced to Article 25 in the 2008 update to the OECD Model.\textsuperscript{1017} This provision applies only where the competent authorities are unable to reach an agreement within two years of the mutual agreement procedure being initiated.\textsuperscript{1018} It is intended to limit the potential for issues to remain unresolved, primarily by encouraging the competent authorities to reach a conclusion before the two year period expires.

The other major criticisms of the mutual agreement procedure generally relate to the nature of the procedure itself. That is, the outcome of the MAP is based on an agreement between the two tax administrations, which are likely to be primarily concerned with the revenue which each of them will be able to collect, or with policy considerations, than with the interests of the taxpayer.\textsuperscript{1019} In addition, the taxpayer generally has no involvement in the negotiations and their interests may not be represented.\textsuperscript{1020} The process also lacks transparency, since agreements reached under the mutual agreement procedure are generally kept confidential and, once an agreement has been reached, the taxpayer may not be informed of the reasoning behind the decisions reflected in the agreement.\textsuperscript{1021}

\textbf{9.2.1.2. Dispute resolution in multilateral situations}

If the PE-S treaty applies in relation to income derived through a PE located in one of the contracting states and arising from sources in the other contracting state, then the person deriving the income should clearly be entitled to initiate the mutual agreement procedure under the PE-S treaty. This would not require a specific provision to be included in the treaty, since there is already an exception to Article 1 under the provision making the treaty applicable in this case. The person deriving the income would therefore be entitled to invoke the MAP if tax is imposed that is not in accordance with the terms of the treaty. Nevertheless, the operation of the MAP may still be problematic in such situations, since the correct application of the PE-S treaty will depend on the interpretation and application of the R-PE treaty, i.e., with respect to whether the income is attributable to a PE in the PE state.

Where, in a PE triangular case, there is a disagreement between the residence state and the PE state regarding whether certain income is attributable to a PE in the PE state, or where the taxpayer disagrees

\begin{itemize}
\item \textsuperscript{1016} OECD Commentary on Article 25, para 37.
\item \textsuperscript{1017} Article 25(5). See also: OECD Commentary on Article 5, paras 63-85; OECD Committee on Fiscal Affairs, "Improving the Resolution of Tax Treaty Disputes," (Paris: OECD, 2007).
\item \textsuperscript{1018} OECD Commentary on Article 25, para 63.
\item \textsuperscript{1019} Holmes states: "...under the mutual agreement procedure, the competent authorities (i.e., the tax authorities are the judges of the propriety of the particular tax impost. We, therefore, have a tax outcome based on an agreement between two tax administrations, the primary focus of each of which is more likely to be budgetary consideration, i.e., revenue protection, or policy driven, rather than the interests of the taxpayer. The result of the mutual agreement procedure is typically arrived at without any involvement of the taxpayer (after it presents its case) or any representation of the taxpayer during the deliberations. By contrast, in judicial proceedings a taxpayer has the opportunity to put its case to the impartial decision maker and be reasonably confident that its arguments will be independently and fairly evaluated against the arguments of the prosecuting tax administration. The mutual agreement procedure therefore lends itself to resolution of disputes involving concessions (or 'horse trading') between the contracting states to ultimately reach a compromise between them (typically concerning revenue sharing) over a particular taxpayer's tax liability. Compare that with the judicial approach of technical analysis of the law (including the provisions of the relevant DTA) to arrive at a tax outcome for the taxpayer based on a judge's statutory interpretation skills and analysis of the facts of the taxpayer's case..." (see: Holmes, K., \textit{International Tax Policy}... at pp. 398-399 (Chapter 20)).
\end{itemize}
with both states regarding the correct application of the R-PE treaty, the taxpayer should initiate the mutual agreement procedure under the R-PE treaty. Where a third state, i.e., the source state, is effected by the outcome of the mutual agreement procedure under the R-PE treaty by virtue of the application of the PE-S treaty, then arguably that state should also be involved in the discussions. This could be difficult, however, due to the bilateral nature of the mutual agreement procedure under tax treaties. In the transfer pricing arena, multilateral agreements are sometimes reached in the context of advance pricing agreements ("APAs"), however this requires the taxpayer to initiate the mutual agreement procedure under each relevant bilateral treaty. Consequently, involving the source state in discussions between the PE state and the residence state would require the taxpayer to invoke the mutual agreement procedure under the PE-S treaty, which the taxpayer may not wish to do. The taxpayer may either have no particular interest in involving the source state, or may be concerned that the source state will argue for a position that is unfavourable for the taxpayer, e.g., where the PE-S treaty is more favourable than the R-S treaty, the source state has an incentive to argue that there is no PE. In addition, even if the taxpayer does invoke the MAP under the PE-S treaty, it would presumably be required to present the request to the PE state (which is the state equivalent to the residence state) and the PE state would only be required to approach the source state if it could not otherwise resolve the issue. If the PE state is confident of resolving the issue with the residence state, then it is unlikely to do this. More importantly, at least from the source state’s perspective, the source state has no authority to request to be included in the negotiations and indeed, may not even be aware that they are taking place. Clearly some mechanism should be introduced to allow third states which have an interest in the outcome of a particular agreement to be involved in the negotiations.

Another issue which may arise where an agreement is reached under the terms of the R-PE treaty, without the involvement of the source state, is that the source state may be unable to implement any corresponding changes in its application of the PE-S treaty. The MAP article contains a specific provision to the effect that any agreement reached can be implemented notwithstanding the time limits contained in domestic law, but this is not the case with respect to third states. Where, for example, the taxpayer initiates the mutual agreement procedure under the R-PE treaty, and the residence state and the PE state ultimately agree that certain income arising in the source state is not attributable to the PE, then the source state may be unable to impose any additional tax on the income that should be imposed as a result of the non-application of the PE-S treaty. Clearly this would be an inappropriate outcome and may warrant a specific provision in the PE-S treaty to set aside domestic time limits in situations where the correct application of the treaty changes on the basis of an agreement reached under the mutual agreement procedure of another tax treaty.

A situation may also arise where the PE state, the residence state, and the taxpayer all agree that there is a PE in the PE state and that the income is attributable to that PE for the purposes of the R-PE treaty, while the source state takes a different view and is thus unwilling to grant treaty benefits to the PE. In this case, the source state will presumably impose tax without applying the conditions of the PE-S treaty, and the taxpayer would be entitled to initiate the mutual agreement procedure under the PE-S treaty. The question arises, however, as to whether the source state should simply be required to accept the PE state’s and the residence state's interpretation and application of the R-PE treaty, and thus accept that there is a PE in the PE state to which the income is attributable. This would clearly be the most straightforward approach, and could be considered reasonable since the interpretation of the R-PE treaty should arguably be a matter for the contracting states; once the two contracting states, and the taxpayer, agree on the interpretation of the treaty and its application to a particular set of facts, it is difficult to see how a third state could legitimately disagree with their interpretation. However, in some cases the PE state and the residence state may be indifferent regarding whether the income is attributable to a PE in the PE state, (e.g., in a situation where the PE state does not seek to impose tax on the income and the residence state

1022 OECD “Transfer Pricing Guidelines,” Annex to Chapter IV: Advance Pricing Arrangements, at pp. 217-219. The report also notes that, depending on the terms of the MAP articles of the various treaties, confidentiality issues may arise in relation to exchanging information between the various tax administrations.

1023 OECD Commentary on Article 25, paras 31-36.

1024 Article 25(2) provides that “[a]ny agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.” However, this exception to the domestic time limits would not apply in third states, i.e., the source state.
uses the credit method of relief), or the PE state and the residence state may have simply accepted the
information included in tax returns filed by the taxpayer and not (yet) conducted an audit or examination.
If there is a discussion regarding whether a PE exists and whether certain income is attributable to that
PE, initiated under the mutual agreement article of the PE-S treaty, then clearly the residence state should
also be involved in these discussions, since the conclusion would effectively relate to the application of
the R-PE treaty and would typically impact on the amount of tax that the residence state is entitled to
impose. However, again, there no opportunity for the residence state to participate unless the taxpayer
also initiates the MAP under the R-PE treaty. This again suggests that some mechanism should be
introduced to allow third states which have an interest in the outcome of a particular agreement to be
involved in the negotiations.

9.2.2. Application of thresholds contained in the PE-S treaty

In some cases, the provisions of tax treaties proscribe different treatment depending on whether or not a
certain threshold is met. The application of these thresholds may be problematic, however, in some cases
involving claims for treaty benefits in PE triangular cases. A good example is the ownership thresholds
which apply for determining the applicable limitation on the rate of source-based taxation of dividends.
Article 10(2) of the OECD Model limits the rate of tax that can be imposed in the state where dividends
arise as follows:

"... the tax so charged shall not exceed:

a) 5% of the gross amount of the dividends if the beneficial owner is a company
   (other than a partnership) which holds directly at least 25% of the capital of the
   company paying the dividends;

b) 15% of the gross amount of the dividends in all other cases."

Thus, the amount of tax that can be imposed in the source state depends upon the ownership interest
which the recipient of the dividends has in the company paying the dividends (i.e., whether it is below
25% or whether it is equal to or above 25%). The first point of note is that the 5% rate applies only
where the beneficial owner of the dividends is a company; if treaty benefits are extended to PEs, this rate
should arguably also be available where dividends are attributable to a PE established by a company.
However, focus of this discussion is on how this threshold should be applied if the company receiving
the dividends owns more than 25% of the shares in the paying company, but only part of the
shareholding is attributable to the PE such that the PE holds less than 25% of the shares in the paying
company.1025 Should the PE be entitled to a reduced rate of withholding tax under the PE-S treaty in this
situation? It would arguably be unfair to apply the higher rate, since the company as a whole meets the
threshold. However, if the shareholding were split between different companies in the same corporate
group, there would generally be no aggregation of their shareholdings1026 and, if the aim is to treat the PE
in the same way as a separate enterprise for treaty purposes, then the application of the threshold in the
case of a PE should be equivalent to its application in the case of a subsidiary. The correct approach for
applying the ownership threshold in this case is unclear, and although this is not likely to be a common
situation, the contracting states should address the application of this threshold, and any other similar
thresholds contained in the treaty1027 when extending treaty benefits to PEs.

1025 Although not likely to be a common occurrence, this could potentially occur, for example, in the case of a global
trading enterprise where traders located in different PEs make separate investments in the same company. However,
given that such investments would commonly be minority investments (e.g., in listed companies) it is nevertheless
likely to be uncommon.

1026 Although certain states may take an economic approach and aggregate shareholdings of related enterprises; in
this case a similar approach should clearly also be applied in situations where part of a shareholding is attributable to a
PE.

1027 In some treaties, for example, source-based taxation is allowed in relation to capital gains arising from the
alienation of shares where the person disposing of those shares has a "substantial participation" (i.e., a shareholding
of more than a certain specified percentage) in the company whose shares are being alienated (see, for example the
reservations of France, Chile, Sweden and Korea in the OECD Commentary to Article 13 of the OECD Model)
A similar issue may also arise in relation to time thresholds contained in tax treaties. The OECD Commentary suggests, for example, that states which require a minimum holding period in order to qualify for a reduced rate of dividend withholding tax under their domestic law may include a similar holding period requirement in their tax treaties. If PEs were entitled to claim benefits under a treaty containing a holding period requirement for reduced rates of dividend withholding tax, an issue may arise in situations where shares are transferred between a PE and the rest of the enterprise, with the result that the shares are not held by the PE for a sufficient time to qualify for the lower rate of withholding. The question in this case is whether the reduced rate should continue to be available notwithstanding that the PE does not satisfy the time threshold, if the entity as a whole has held the shares for a sufficient period of time. Again, to the extent that treaty articles proscribe different treatment depending on whether or not a certain threshold is met, the contracting states should consider the application of the threshold in situations involving PEs, and should provide guidance regarding how the thresholds should be applied.

9.2.3. Attribution of investment income to insurance PEs

PE triangular cases are likely to occur with relative frequency in the insurance industry, firstly because insurance companies hold substantial investment assets and secondly, because they commonly operate through PEs for regulatory reasons. Clearly the combination of these two factors can lead to PE triangular cases. However, the process of determining the investment income attributable to an insurance PE, which will be discussed below, may make it significantly more difficult to apply the PE-S treaty in relation to the investment income of insurance PEs.

An insurance company accepts risks from customers who, in return, pay insurance premiums. Part of the income from these premiums is set aside in reserves to pay future claims under the insurance policies. Insurance companies must also maintain a "surplus" to absorb any losses in excess of reserves, which essentially reflects the company's equity. The two primary sources of income for insurance companies are therefore premiums received from customers, and investment income from the invested reserves and surplus. Under the AOA, the determination of the profit attributable to a PE of an enterprise carrying on an insurance business is determined on the basis of "key entrepreneurial risk taking functions" ("KERT functions"). However, an insurance enterprise will have only one KERT function, being the assumption of insurance risk (i.e., the risk assumed by the insurer under insurance policies). The following section outlined in greater detail the process for determining the income attributable to an insurance PE, while the following section goes on to discuss the unique problems this creates with applying the PE-S treaty in PE triangular cases.
9.2.3.1. Attribution of investment assets to insurance PEs

Under the AOA, investment assets must be allocated to PEs operating in the insurance industry on the basis of the insurance risks which are assumed by the PE, since it is the assumption of risk that gives rise to the need to maintain a pool of investment assets.\(^{1038}\) The goal is for the investment assets attributed to the PE to reflect the total amount of assets that the PE would hold if it were a "distinct and separate enterprise operating at arm's length."\(^{1039}\)

The AOA gives several alternatives for determining the total investment assets attributable to an insurance PE. The first is the "capital allocation approach", under which the total investment assets belonging to the organization are allocated to the different parts of the enterprise in proportion to the insurance risk assumed by each part.\(^{1040}\) Assets could be allocated, for example, on the basis of reserves for insurance risks, premium income, or minimum regulatory asset requirements.\(^{1041}\) The second approach is the "Thin capitalization / adjusted regulatory minimum approach." Under this approach, investment assets are attributed to an insurance PE by reference to "the amount of investment assets of an independent insurance enterprise carrying on the same or similar activities and assuming the same or similar risks under the same or similar conditions."\(^{1042}\) The reserves and surplus included in the PEs regulatory filings are used as a starting point, to be adjusted as necessary.\(^{1043}\) The OECD Report also suggests a "safe harbour – quasi-thin capitalization / regulatory minimum approach", under which the PE would be required to have an amount of investment assets at least equal to its reserves under the host country’s regulatory regime, plus the minimum surplus of an independent enterprise operating in the host country.\(^{1044}\) All of these approaches determine the total amount of investment assets attributable to a PE, but would not generally identify specific assets which are considered to be attributable to the PE.\(^{1045}\) A second step is therefore required to determine the amount of investment income attributable to the PE.

9.2.3.2. Determining the investment income attributable to an insurance PE

Certain assets may be directly identified as being attributable to the PE, in which case the income arising from those assets should also be attributed to the PE. The clearest example is a situation where the host state, i.e., the PE state, requires certain assets to be placed in trust ("trussteed assets") to satisfy insurance claims in that state, in which case it would be appropriate to attribute the income arising from those assets to the PE.\(^{1046}\) The OECD Report on the Attribution of Profits to PEs also states that, in general, the investment return attributed to the PE should closely correspond to the return on the assets held in the host country (including trussteed assets),\(^{1047}\) which seems to suggest that assets located in the PE state may be attributed to the PE in preference to assets located in third states. This would of course minimise the extent to which the income attributable to the PE includes investment income arising in third states, and thus minimise the occurrence of PE triangular cases.

As noted above, however, the process for allocating investment assets to a PE may not result in a direct identification of the specific assets which are considered to be attributable to the PE, in which case the AOA requires the investment income attributable to the PE to be determined indirectly.\(^{1048}\) The OECD

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1038 OECD, "2010 Report…," Part IV, Section C, para 81, which states: "The factual starting point for the attribution of investment assets to an insurance PE is that the assets representing surplus and reserves are primarily required to support the risks assumed by the enterprise. These assets must be regarded as following those risks. In other words, investment assets are to be attributed to a PE by reference to the insurance risk arising from its acceptance of insured risks, and not the other way round." See also: OECD, "2010 Report…," Part IV, Section C-1(iii), para 127.
1039 OECD, "2010 Report…," Part IV, Section C-1(iii), para 128.
1040 OECD, "2010 Report…," Part IV, Section C-1(iii), para 131.
1041 OECD, "2010 Report…," Part IV, Section C-1(iii), paras 143-152.
1042 OECD, "2010 Report…," Part IV, Section C-1(iii), para 153.
1043 OECD, "2010 Report…," Part IV, Section C-1(iii), para 154.
1044 OECD, "2010 Report…," Part IV, Section C-1(iii), para 156.
1045 OECD, "2010 Report…," Part IV, Section C-1(iii), paras 137 and 165.
1046 OECD, "2010 Report…," Part IV, Section C-1(iii), para 166.
1047 OECD, "2010 Report…," Part IV, Section C-1(iii), para 166.
1048 OECD, "2010 Report…," Part IV, Section C-1(iii), para 165.
Report suggests two approaches for determining the investment income attributable to an insurance PE; the "top-down approach" and the "bottom-up approach." Under the top-down approach, to the extent that the investment assets attributable to the PE exceed the assets held in the host country, those additional assets should be deemed to earn a rate of return equal to either; (i) that earned on all the "uncommitted" (i.e., non-trusted) assets held by the company as a whole,1049 (ii) the rate of return on all the investment assets held by the company,1050 or (iii) the rate of return on the categories of uncommitted assets which are most appropriate to associate with the PE, e.g., based on the currency in which the assets are denominated.1051 Under the "bottom-up approach," the investment income attributable to the PE is determined on the basis that the return on any investment assets attributable to the PE in excess of the assets held in the host country is the same as the return on the assets held in the host country.1052 The result under either approach necessarily constitutes a proxy for the actual return on the investment assets.1053

9.2.3.3. Implications for application of PE-S treaty to investment income of insurance PEs

The investment income attributable to an insurance PE is likely to include income arising in relation to investments outside the PE state, however, there will generally be no specific identification of the items of income attributable to the PE, and thus no specific identification of the nature or geographical source of the income. This would clearly make it problematic, to say the least, to apply the terms of treaties concluded between the PE state and the third states where investment income arises.

One alternative would be for the income attributable to PEs of insurance companies to be excluded from the application of the PE-S treaty. As a result, source states would continue to apply the conditions of the R-S treaty in relation to all the investment income derived by the company, regardless of the extent to which it is attributable to one or more PEs. However, this means that PE triangular cases remain unresolved in the case of insurance companies, an industry in which, as discussed above, such cases may occur relatively more frequently than in other industries. Like in other industries, a lack of relief in the PE state may result in unrelieved double taxation, since the residence state may not be in a position to provide sufficient relief for the tax imposed in both the source state and the PE state. A specific requirement for the PE state to grant relief, which could be based on, e.g., the average rate of source-based taxation imposed on the company's investment income, may go some way to resolving the issue of double taxation, but this would not resolve the issue of the applicable conditions in the source state and it is likely to be difficult to determine the appropriate amount of relief. Another alternative would be to allow insurance companies to determine which specific investment assets are attributable to each of PEs on some reasonable basis. However, depending upon the basis used to allocate investment assets, this would potentially be open to abuse, i.e., by attributing each asset to a PE located in the state which has the most favourable treaty with the source state. Regardless of the approach taken, special rules would clearly be required to deal with PEs in the insurance industry.

9.2.4. Income and capital gains arising from immovable property

Under tax treaties that follow the OECD Model, the distribution of taxing rights in relation to income from immovable property is not based on the existence of a PE. Instead, Article 6 provides that the state where immovable property is located may impose tax on the income arising from that property without limitation.1054 However, as discussed in Chapter 2 (Section 2.6.), the application of tax treaties to income from immovable property is unclear in situations where the property is situated in a third state. In such cases, Article 6 does not apply because the definition of the term "immovable property" only applies if

1049 OECD, "2010 Report…," Part IV, Section C-1(iii), para 167.
1050 OECD, "2010 Report…," Part IV, Section C-1(iii), para 167.
1051 OECD, "2010 Report…," Part IV, Section C-1(iii), para 168.
1052 OECD, "2010 Report…," Part IV, Section C-1(iii), para 170.
1053 OECD, "2010 Report…," Part IV, Section C-1(iii), para 170.
1054 Article 6 of the OECD Model provides that: "Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other state."
the property in question is situated in one of the contracting states. It is therefore not clear whether the income should fall under Article 7, in which case the PE state would be entitled to impose tax, or Article 21, in which case the PE state may be prevented from imposing tax. For the reasons discussed in Chapter 2, the better view seems to be that Article 7 should generally apply, but the application of treaties to income from immovable property located in third states should be clarified.

This issue may become more pressing if treaty benefits are extended to PEs, because the ability of the PE state to impose tax will influence whether the PE-S treaty should be applied (instead of the R-S treaty) in relation to income from immovable property located in State S. If the R-S treaty and the PE-S treaty both follow the OECD Model with respect to immovable property, then there would generally be no difference in the amount of tax the source state could impose on the income under the conditions of those two treaties. However, a situation could arise where the terms of the two treaties differ, e.g., with respect to the definition of immovable property, and thus where the source state may be entitled to impose tax under the terms of one treaty but would be prevented from imposing tax under the terms of the other. The application of the R-PE treaty in relation to income arising from immovable property situated in a third state should therefore be clarified, and the determination of the applicable treaty conditions (i.e., the R-S treaty or the PE-S Treaty) should follow the distribution of taxing rights under the R-PE treaty. Preferably, the R-PE treaty would provide that the PE state is entitled to impose tax on the income and the PE-S treaty would be applied in both the PE state and the source state in relation to the income.

A similar issue arises in relation to capital gains from the alienation of immovable property. Under existing tax treaties, capital gains arising from the alienation of immovable property located in a third state are not covered by Article 13(1) because that provision refers to the definition of immovable property in Article 6 which is inapplicable where the property is located in a third state. Instead, the gain will fall under Article 13(5), dealing with capital gains from other property (i.e., property not dealt with in other paragraphs of Article 13), which will prevent the PE state from imposing any tax. This is inconsistent with the taxation of income arising from immovable property located in a third state, where the PE state may be entitled to impose tax under Article 7. The distribution of taxing rights in relation to capital gains under Article 13 is intended to correspond to the distribution of taxing rights in relation to the corresponding categories of income under the other articles of the treaty. If the PE state is entitled to impose tax on income from immovable property located in third states, which I believe it should be (particularly if the PE-S treaty applies such that there will be no unrelieved double taxation), then the PE state should also be entitled to impose tax on capital gains from the alienation of immovable property located in third states. This would require a change to the terms of the treaty. It could be achieved by, for

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1055 Article 6(2) contains the following definition of immovable property: "The term 'immovable property' shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property." See also: OECD Commentary on Article 6, para 1.

1056 See Section 2.6. It was concluded in Chapter 2 that if income from immovable property situated in a third state is considered to be business income under the domestic law of the PE state, then it should also be considered to be business income for the purposes of the R-PE treaty. The income should not be considered to be "dealt with separately" in Article 6 and thus, Article 7(4) should not apply. As a result, where the income is considered to be business profits the distributive rule of Article 7 should apply; this would allow the PE state to impose tax on the income. If the income is not considered to be business profits or, alternatively, is considered to be business profits but is also considered to be "dealt with" in Article 6, such that Article 7 would not apply directly, the distributive rule of Article 7 should still ultimately apply as a result of the application of Article 21(2). This would again allow the PE state to impose tax on the income. The only situation in which the distributive rule of Article 21(1) should apply for the purposes of the R-PE treaty in a PE triangular case is if (i) the income is not considered to be business income and (ii) the property from which the income arises falls within one of the categories of property which is always considered to be immovable property under Article 6(2), without reference to the domestic laws of the Contracting States, such as livestock and equipment used in agriculture and forestry. In this case, Article 21 will apply and Article 21(2) will not operate to shift the income to Article 7.

1057 This issue will be outlined here, but was also discussed in Chapter 2 (see Section 2.8.1.).

1058 OECD Commentary on Article 13, para 4.
example, amending Article 13(2) dealing with movable property forming part of the business property of a PE in a way that would make it apply also to capital gains from the alienation of immovable property forming part of the business property of the PE. The amended Article 13(2) could read:

"Gains from the alienation of property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other contracting state."

In situations where the immovable property is located in the PE state (i.e., in bilateral cases), the PE state would be entitled to impose tax under Article 13(1) (dealing with capital gains from the alienation of immovable property) or Article 13(2). Article 13(1) would be intended to have priority over Article 13(2), being more specific, but in any case the result would be the same regardless of which of these two articles applied, i.e., the PE state (the state where the immovable property is located) would be entitled to impose tax. In a PE triangular case, where a person derives a capital gain from the alienation of movable property located in a third state and that gain is attributable to a PE, the PE state would be entitled to impose tax on the gain under Article 13(2).

9.2.5. Sub-PE triangular cases

Sub-PE triangular cases\textsuperscript{1059} give rise to specific problems with respect to the application of the PE-S treaty because a PE exists in both the PE state and the source state (i.e., the sub-PE state). This means that in the absence of any specific way of dealing with sub-PE triangular cases, the reductions in source-based taxation available under the PE-S treaty (the PE-SPE treaty) and the relief provisions of that treaty could be claimed both from the perspective of the PE (i.e., in relation to the tax imposed in the sub-PE state) and from the perspective of the sub-PE (i.e., in relation to the tax imposed in the PE state). Clearly this would be an inappropriate outcome and would be particularly problematic in relation to the provision of relief (as discussed in Chapter 4, Section 4.3.6.).

One way of dealing with this would be to include a provision in the article extending treaty benefits to PEs which would exclude sub-PES and thus prevent sub-PES from claiming treaty benefits. However, this increase in the complexity of the provision may not be warranted given that sub-PE triangular cases are likely to be extremely uncommon. Perhaps the best way of dealing with sub-PE triangular cases would be through the attribution of income, by ensuring that income can never be attributable to more than one PE. For example, in the case of a PE arising as a result of a regional headquarters and with a sub-PE arising as a result of local activities carried out in another state (and under the supervision of the regional headquarters), this could be done by providing that the income attributable to the regional headquarters includes only remuneration for its management activities and not any other income earned through the sub-PE. Conversely, the income attributable to the sub-PE would be appropriately reduced by the amount of income attributable to the regional headquarters. The determination of the income attributable to each of the two PEs (the PE and the sub-PE) would of course depend on the circumstances of each particular case. Thus, it is suggested that a general principle be introduced to the effect that a particular item of income cannot be attributable to more than one PE. In situations where there are two PEs, a proper factual and functional analysis should determine which of those two PEs the income is properly attributable to or how much of the income is properly attributed to each PE. This could be implemented through changes to the guidelines on the attribution of profit to PEs and any disagreements regarding the attribution of the profit could then be resolved through the mutual agreement process.

9.3. Application of the R-PE treaty and recognition of notional dealings

An important limit on the separate enterprise approach is that a PE is treated as a separate enterprise only for the purposes of determining the amount of profit attributable to the PE and the amount of relief to be provided in the residence state. The PE is not considered to be a separate entity for the purposes of

\textsuperscript{1059} For an overview of sub-PE triangular cases, refer to Chapter 2 (Section 2.4.1.).
applying other articles of the treaty. Baker and Collier, discussing the shift towards greater independence for PEs under the AOA, write:

"...it is fair to say that the AOA does not go to the absolute extreme of independence – what one might call the 'full monty' separate enterprise. On that approach, if one were to attribute assets, risks and capital to the FSE [functionally separate enterprise], there seems no reason why the FSE should not be regarded as a resident of state H [i.e., the PE state], capable of taking the benefit of the DTCs entered into by state H, and, if domestic law requires, operating a withholding of tax on the payment of (notional) royalties, rents, interest (and possibly technical service fees) deemed to be paid to other parts of the enterprise."

The focus of this section will be on the extent to which a PE should be considered to be a separate enterprise for treaty purposes, i.e., whether the separate enterprise treatment should go further than allowing the PE to claim benefits under the PE-S treaty. More specifically, it will address the question of whether the PE should be considered a treaty-eligible resident of the PE state for the purposes of the R-PE treaty (i.e., in relation to income arising in the residence state), and whether notional dealings between the PE and the rest of the enterprise should be recognised for treaty purposes beyond the determination of the profit attributable to the PE. This would not be required in order to resolve the issues arising in PE triangular cases, however, if a PE is treated as a separate enterprise for the purposes of the R-PE treaty, then it seems fair to consider how far the approach of treating the PE as a separate enterprise for treaty purposes should be taken. This section can address these issues only briefly and they are largely beyond the scope of this thesis; the following discussion is intended merely to highlight some of the issues that may arise if PEs are treated as separate enterprises for the purposes of the R-PE treaty and for the purposes of applying treaties to notional payments between different parts of an enterprise.

Note that source based taxation of payments which originate in the PE state and are borne by the PE (including payments to residents of State R) will be discussed in Chapter 12, which deals with reverse triangular cases, and will thus not be discussed in detail in this section.

9.3.1. Application of the R-PE treaty to income derived from sources in the residence state

Treating the PE as a resident of the PE state would involve both the PE state and the residence state imposing tax as though the situation involved a parent company resident in State R with a subsidiary company in the PE state. This would involve requiring the residence state to exempt the profit attributable to the PE, since the income would not be included in the tax base in the residence state (i.e., of the parent company) if it were derived by a subsidiary company. It would also involve allowing the residence state to impose source-based taxation on income paid by its residents to foreign PEs of resident enterprises as though it were paid, not to a resident enterprise, but instead to an enterprise resident in the PE state; this implies that the residence state would be entitled to impose "source-based" taxation on such income. In the PE state, the income attributable to the PE may be taxed in the normal way, but the PE state would be required to grant relief for source-based taxation imposed in the residence state in relation to income attributable to the PE. This would clearly be a drastic departure from current principles, and would likely have a much greater impact on the distribution of taxing rights and the application of tax treaties than allowing PEs to claim treaty benefits under treaties with third states, since it would also have an impact in bilateral cases.

One problem with treating the PE as a resident of the PE state for the purposes of the R-PE treaty is that the actual imposition of tax in the residence state would depend on that state’s domestic law and, given

1060 2010 OECD Commentary on Article 7, para 28.
1061 The Authorised OECD Approach (AOA) for determining the profit attributable to a PE was discussed in detail in Chapter 5 (see Section 5.2.5).
1063 One possible exception is situations where the income would be taxed in the residence state of the parent entity under controlled foreign companies (CFC) rules. To simplify the discussion in this section, it will be assumed that the residence state either does not have CFC rules or that they would not be applicable if a subsidiary of a resident entity derived the income in question.
the novelty of taxing locally sourced income of a resident taxpayer as though it were derived by a non-
resident, there are likely to be mismatches between the treaty provisions and domestic laws. This may not
be prohibitive, since the treaty simply sets the maximum amount of tax that the residence state can
impose, and does not require that the tax be imposed on the basis of "source" or, for example, by way of
a withholding tax and, in addition, any tax liability would continue to be imposed on the entity resident in
State R from a legal and administrative perspective. Nevertheless, the mismatch between the
characterisation of the situation for domestic law purposes and the characterisation of the situation for
treaty purposes may give rise to significant problems if such an approach were implemented in tax
treaties.

The following sections will discuss the potential application of the R-PE treaty in relation to various
categories of income if the PE were treated as a separate, treaty eligible enterprise for the purposes of the
R-PE treaty. As will be seen below, this would generally require firstly, applying the R-PE treaty from the
perspective of the person resident in State R to determine the existence of the PE and the profit
attributable to the PE, and then, secondly, applying the treaty from the perspective of the PE in relation
to any income arising from sources in State R.

9.3.1.1. Passive income

Under existing tax treaties the treatment of income which is derived by a resident of a contracting state
from sources in its residence state, but which is attributable to a PE in the other contracting state,
depends upon whether the residence state uses the credit method or the exemption method of relief in
relation to the income attributable to the PE. If the residence state uses the credit method, then the
income remains within the taxable income of the person deriving it and the residence state must provide a
credit for any tax imposed on the income in the PE state. However, if the residence state exempts the
income attributable to the PE, then the residence state is effectively required to exempt the income
regardless of the fact that it is locally sourced income of a resident enterprise (this will be demonstrated in
the example below). Under this existing framework, the residence state is not entitled to impose any
withholding tax on such income.

If, however, the PE-S treaty were applied in such a way that income attributable to a PE was considered
to be derived by a resident of the PE state, then the residence state should arguably be entitled to impose
tax on passive income arising from sources in the residence state and attributable to the PE. The treaty
would continue to require the residence state to exempt the income attributable to the PE, but would
effectively contain an exception for situations where the residence state would be entitled to impose tax
on a source basis if the income were derived by a resident of the PE state.

Treating the PE as a resident of the PE state for the purposes of the R-PE treaty would require a multi-
step analysis, as follows:

1. An initial application of the R-PE treaty on the basis that the income is derived by a resident of
State R. This would involve:
   a. The determination that a PE exists under Article 5 and the application of Article 7.
      Under Article 7, the PE state would be entitled to impose tax on the profit attributable
to the PE.
   b. The application of Article 23A/B, requiring the residence state to grant relief for source-
based taxation imposed in the PE state, in this case, assumed to be an exemption.

2. A secondary application of the R-PE treaty on the basis that the income is derived by a resident
of State PE. This would involve:
   a. The application of Article 10, Article 11 or Article 12 (depending on the type of passive
      income involved). For the purposes of applying these articles, the income would be
      considered to arise in the residence state and the residence state would therefore be
      entitled to impose a limited rate of tax on the income in accordance with Article 10, 11
      or 12, as applicable.
b. The application of Article 23A/B, requiring the PE state to grant relief for source-based taxation imposed in the residence state. Given that the income is passive income, the credit method would generally apply, and the PE state would be required to provide a credit for tax imposed on a source basis in the residence state.

This is demonstrated in the following example.

Example

A company resident in State R derives $100 of interest income from sources in State R. The income is attributable to a PE in State PE under the R-PE treaty. Under the R-PE treaty, State R exempts the income attributable to the PE. The R-PE treaty is applied as though the income were derived by a resident of State PE and accordingly, State R is entitled to impose source-based taxation on the income in accordance with the interest article of the treaty (Article 10). Under Article 10, source-based taxation of interest is limited to 10% of the gross amount of the income. The general company tax rate in both State R and State PE is 25%. This situation is illustrated in the following diagram.

Figure 9.1.: Example showing application of R-PE treaty if PE is treated as a resident of the PE state

The table below compares (i) the situation where the R-PE treaty is applied as though the PE were a resident of State PE and (ii) the situation where the PE is not treated as a resident of State PE for the purposes of the R-PE treaty.

<table>
<thead>
<tr>
<th></th>
<th>(i) PE is a resident of State PE for the purposes of the R-PE treaty</th>
<th>(ii) PE not a resident of State PE for the purposes of the R-PE treaty</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Source-based&quot; tax imposed in State R</td>
<td>10\textsuperscript{1064}</td>
<td>N/A</td>
</tr>
<tr>
<td>Tax imposed in State PE</td>
<td>25\textsuperscript{1065}</td>
<td>25\textsuperscript{1066}</td>
</tr>
<tr>
<td>Less: Credit for source-based tax imposed in State R</td>
<td>(10)</td>
<td>N/A</td>
</tr>
<tr>
<td>Tax collected in State PE</td>
<td>15</td>
<td>25</td>
</tr>
<tr>
<td>&quot;Residence-based&quot; tax collected in State R</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total tax collected in State R</td>
<td>10</td>
<td>-</td>
</tr>
</tbody>
</table>

\textsuperscript{1064} State R imposes source-based tax of 10% on $100 of interest income. The tax imposed is therefore $10.

\textsuperscript{1065} $100 \times 25\% = $25

\textsuperscript{1066} $100 \times 25\% = $25

\textsuperscript{1067} State R exempts the income attributable to the PE and therefore imposes no residence-based taxation.
This demonstrates that if there were a secondary application of the R-PE treaty on the basis that income derived from sources in State R and attributable to the PE were derived by a resident of State PE, the residence state may be entitled to collect more tax in relation to passive income arising in the residence state than it would under the existing framework. The tax collected in State R would reduce the amount of tax collected in State PE as a result of the relief mechanism of the treaty, which the PE state would also be required to apply. This would clearly be very complicated to apply in practice, particularly given that the facts are unlikely to be as straight-forward as those presented in the above example. It also would require a completely separate calculation process to be conducted for the purposes of determining the limit on the amount of tax the residence state could impose under the treaty, which would not necessarily be linked to the calculation required for the purposes of determining the applicable tax liability under the domestic law of the residence state.

9.3.1.2. Passive income where the residence state uses the credit method in relation to PE income

Treating the PE as a resident of the PE state for the purposes of the R-PE treaty would imply that the residence state should exempt the profit attributable to the PE. Allowing the residence state to continue to impose tax on the profit attributable to the PE on a residence basis (and providing relief using the credit method) would arguably be inconsistent with treating the PE as a separate taxable entity for treaty purposes. However, it is likely that requiring an exemption would be unacceptable to states that use the credit method as the exclusive method of relief in their treaties. This may be somewhat offset by the potential ability of the residence state to impose a greater level of tax on locally sourced income attributable to foreign PEs of resident enterprises (as shown in the example in the previous section), but such income is not likely to represent the bulk of the income attributable to foreign PEs, which is most likely to arise from sources in the PE state. The discussion in this section will therefore consider how the R-PE treaty could be applied if the PE is treated as a resident of the PE state and the residence state uses the credit method.

Where the residence state uses the credit method to provide relief in relation to the profit attributable to the PE, the application of the PE-S treaty as though the income were derived by a resident of the PE state would be particularly difficult. It would require a similar multi-step analysis to that discussed above in relation to the exemption method, with the exception that the amount of (credit) relief in the residence state would depend on the amount of tax imposed in the PE state, taking into account the availability of relief in the PE state for tax imposed on a source basis in State R. This is demonstrated in the following example.

Example: A company resident in State R derives $100 of interest income from sources in State R. The income is attributable to a PE in State PE under the R-PE treaty. Under the R-PE treaty, both contracting states use the credit method of relief. The R-PE treaty is applied as though the income were derived by a resident of State PE and therefore, State R is entitled to impose source-based taxation on the income in accordance with the interest article (Article 10) of the R-PE treaty. Under Article 10, source-based taxation of interest is limited to 10% of the gross amount of the income. The general company tax rate in both State R and State PE is 25%. This situation is illustrated in the following diagram.

Figure 9.2.: Example showing the application of R-PE treaty if PE is treated as a resident of the PE state
The table below compares (i) the situation where the R-PE treaty is applied as though the PE were a resident of State PE and (ii) the situation where the PE is not treated as a resident of State PE for the purposes of the R-PE treaty.

<table>
<thead>
<tr>
<th></th>
<th>(i) PE a resident of State PE for the purposes of the R-PE treaty</th>
<th>(ii) PE not a resident of State PE for purposes of R-PE treaty</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Source-based&quot; tax imposed in State R</td>
<td>101068</td>
<td>N/A</td>
</tr>
<tr>
<td>Tax imposed in State PE on profit attributable to PE</td>
<td>251069</td>
<td>251070</td>
</tr>
<tr>
<td>Less: Credit for source-based tax imposed in State R</td>
<td>(10)</td>
<td>N/A</td>
</tr>
<tr>
<td>Tax collected in State PE</td>
<td>15</td>
<td>25</td>
</tr>
<tr>
<td>&quot;Residence-based&quot; tax imposed in State R</td>
<td>301071</td>
<td>301072</td>
</tr>
<tr>
<td>Less: Credit for tax imposed in State PE</td>
<td>(15)</td>
<td>(25)</td>
</tr>
<tr>
<td>&quot;Residence-based&quot; tax collected in State R</td>
<td>15</td>
<td>5</td>
</tr>
<tr>
<td>Total tax collected in State R</td>
<td>201074</td>
<td>5</td>
</tr>
</tbody>
</table>

In both cases, the total amount of tax collected in relation to the income is $30 and there is no unrelieved double taxation. However, where the income is treated as being derived by a resident of the PE state for the purposes of the R-PE treaty, thus allowing the residence state to impose "source-based" taxation, the share of tax collected by the residence state increases.

9.3.1.3. Business profits and "other income"

The income attributable to the PE may include income from sources in the residence state which would be categorised as either business profits (under Article 7) or "other income" (under Article 21). This is illustrated in the following diagram.

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1068 State R imposes source based tax of 10% on $100 of interest income. The tax imposed is therefore $10.
1069 $100 x 25% = $25
1070 $100 x 25% = $25
1071 $100 x 30% = $30.
1072 $100 x 30% = $30.
1073 It is assumed that the residence state is not required to provide a credit for the tax it imposes on the interest paid to the PE, since granting such a credit would not be consistent with treating the PE as a separate entity. If the situation involved a payment from a resident of State R to a company resident in State PE, the residence state would generally not grant such relief (although there may be indirect credits available for underlying taxes in relation to dividends, at least under domestic law). However, granting a credit for the withholding tax imposed on the payment to the PE would be consistent with the treatment of income attributable to the PE and arising in third states, in which case the residence state would have an obligation to provide credit relief under the R-S treaty; this suggests that State R should perhaps have an obligation to grant a credit for the withholding tax it imposes on the payment.
1074 This is the total of the "source-based" taxation imposed on the interest paid to the PE and the "residence-based" tax imposed on the resident enterprise,
If the PE were entitled to treaty benefits under the R-PE treaty then the residence state would not be entitled to impose any source-based taxation on the income under either Article 21 or Article 7. The application of the R-PE treaty as though the PE were a resident of the PE state would therefore have no impact on the taxation of business profits or other income derived from sources in the residence state. The income would simply be taxable in the PE state and in the residence state in accordance with the normal terms of the treaty, with the residence state obliged to grant relief for tax imposed in the PE state (either by exempting the income or by granting a credit).

9.3.1.4. Income from immovable property

Under Article 6, income arising from immovable property may be taxed in the state where the immovable property is located. In so-called "bilateral triangular cases" involving immovable property, i.e., in situations where a person derives income from immovable property situated in their residence state which is attributable to a PE in a second state, it is clear that Article 6 applies. As a result, the PE state is prevented from imposing tax on the income based on the normal application of the R-PE treaty. This is illustrated in the following diagram.

If PEs are eligible for treaty benefits, therefore, the PE should not be considered to derive such income for treaty purposes and the R-PE treaty should not be applied as though the income were derived by a resident of the PE state.

9.3.1.5. Income from shipping, inland waterways transport and air transport

Under Article 8, income from shipping, inland waterways transport and air transport is only taxable in the state where the place of effective management is located (or, under many existing treaties, in the state of residence). In a PE triangular case, the R-PE treaty would therefore not allow the PE state to impose

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1075 This result in relation to income from immovable property arising in the residence state would somewhat inconsistent with the treatment of income arising from immovable property situated in a third state. The application of tax treaties to income from immovable property situated in a third state was discussed in Chapter 2 (Section 2.6.) where it was concluded that such income should be taxable in the PE state under Article 7 of the R-PE treaty, with the result that the PE should be entitled to treaty benefits under the PE-S treaty in relation to such income. This inconsistency will be discussed further in Section 9.2.4., below.

1076 Based on a survey of treaties between OECD member states and between OECD member and non-member states, Maisto identifies that around 47% of treaties follow the wording in the OECD Model (allocating exclusive taxing rights to the state where the place of effective management is located) and around 44-48% of treaties base the allocation of taxing rights on residence. Thus, 85-90% of treaties base the allocation of taxing rights on either the
any tax on such income and the source state would not be obliged to apply the conditions of the PE-S treaty. Given that the PE-S treaty does not apply in a triangular situation, the R-PE treaty should also not be applied as through the income were derived by a resident of the PE state. That is, the normal operation of the R-PE treaty should continue and the PE state should be prevented from imposing any tax.

9.3.1.6. Capital gains

The distribution of taxing rights in relation to capital gains depends on the type of asset from which the capital gains arise. The various types of capital gains dealt with in the OECD Model will therefore be discussed in turn below.

**Immovable property:** Where the income attributable to a PE includes capital gains arising from the alienation of immovable property situated in the residence state (illustrated in the diagram below), those capital gains cannot be taxed in the PE state under the terms of the R-PE treaty based on the normal application of that treaty. The PE should therefore not be entitled to claim treaty benefits in relation to such gains under the R-PE treaty.

*Figure 9.5.: Application of the R-PE treaty to capital gains arising from immovable property located in State R*

**Movable property attributable to a PE:** Article 13(2) deals with capital gains arising in relation to movable property forming part of the business property of a PE in the other contracting state. If there is movable property located in the residence state which is attributable to the PE in the PE state then, under the normal application of the R-PE treaty, the PE state would be entitled to impose tax on such income in accordance with Article 13(2). Therefore, if the PE is entitled to treaty benefits under the R-PE treaty, then treaty benefits should be available in relation to these types of capital gains. However, Article 13(2) will not apply for the purposes of this application of the R-PE treaty from the perspective of the PE, unless the property is attributable to a "sub-PE" in the residence state (and thus attributable to both sub-PE and the PE claiming treaty benefits). In general, assuming the gain is not attributable to a "sub-PE" in the residence state (of the enterprise as a whole; this is illustrated in the diagram below), Article 13(5) would apply and that state would not be entitled to impose any source-based taxation on the gain.

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1077 Article 13(1) provides that: "Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other state." Thus, Article 13(1) allows the state where the property is situated to impose tax on any gains from its alienation. However, Article 13(1) does not apply if the property is situated in the residence state, in which case Article 13(5) applies. Under Article 13(5) the gains may only be taxed in the residence state.

1078 Refer to Chapter 2 for a discussion of the issues associated with sub-PEs (see Section 2.2.3.1.).
Shipping and air transport: Where the profit attributable to the PE includes capital gains arising from the alienation of assets involved in a shipping or air transport enterprise, the PE state would be prevented from imposing tax on those gains under Article 13(3), based on the normal application of the R-PE treaty. The PE should therefore not be entitled to claim treaty benefits under the R-PE treaty in relation to such capital gains.

Shares in real property companies: Similarly, where capital gains attributable to the PE arise from the disposal of shares in a company holding immovable property in the residence state, the PE state would be prevented from imposing tax under Article 13(4), based on the normal application of the R-PE treaty, and the PE should therefore not be entitled to claim treaty benefits under the R-PE treaty in relation to such capital gains.

Other assets: Similarly, where the profit attributable to the PE includes capital gains arising from the alienation of assets not covered by any other paragraphs of Article 13, the PE state would be prevented from imposing tax on those gains under Article 13(5) of the R-PE treaty. The PE should therefore not be entitled to claim treaty benefits under the R-PE treaty in relation to such capital gains.

9.3.1.7. Conclusions

Allowing the PE to claim treaty benefits under the R-PE treaty would be consistent with treating the PE in the same way as a separate enterprise for treaty purposes. However, this approach is not necessary for resolving the issues that arise in PE triangular cases and the main impact of such an approach would be felt in bilateral cases, which represent the vast majority of situations involving PEs. It would also be extremely complicated to apply in practice, as is evident from the analysis above. If the PE were recognised as a treaty eligible enterprise under the R-PE treaty, the application of the R-PE treaty would require a two step process. First, the R-PE treaty would have to be applied from the perspective of the resident of State R to determine that a PE exists and to distribute taxing rights between State R and State PE in relation to the income attributable to the PE (i.e., under Article 7). The R-PE treaty would then have to be applied again, with the PE being treated as a resident of the PE state, to determine the source based taxation that could be imposed in State R. The provision of relief would also be complicated, since the PE state should be required to provide relief for tax imposed on a source-basis in the residence state. Finally, issues may arise as a result of the mismatch between the characterisation of the situation for treaty purposes and the legal nature of the situation, upon which the characterisation under domestic law is likely to be based. These complications seem to outweigh the benefit of the theoretical consistency of treating the PE as a separate, treaty-eligible enterprise for the purposes of the R-PE treaty.

1079 Article 13(4) provides that “gains derived by a resident of one Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.” Concluded treaties may also allow source based taxation of capital gains arising from the alienation of shares which represent substantial participations, or where the underlying assets of the company are located in the other contracting state (i.e., not the source state); refer to Chapter 2 for further information (Section 2.8.4.).
9.3.2. Treatment of notional dealings

One of the limits which has historically been placed on the separate entity approach for determining the profit attributable to a PE relates to the treatment of dealings between the PE and other parts of the enterprise. With the adoption of the AOA,1080 this limit has essentially been removed and replaced with a framework for assessing whether a particular dealing meets the criteria for recognition. Under the AOA, an internal dealing may be recognised for profit attribution purposes if a "real and identifiable event has occurred."1081 According to the OECD report, "[t]his requires a determination of whether there has been any economically significant transfer of risks, responsibilities and benefits as a result of the 'dealing'."1082 As a result, it is now possible for internal dealings such as payments of royalties or service fees to be recognised for the purposes of determining the profit attributable to the PE. In some circumstances, it may also be possible to recognise internal interest payments, including a profit margin; namely, where part of the enterprise conducts treasury operations.1083 Thus, the AOA has greatly expanded the situations in which internal dealings may be recognised for profit attribution purposes.

Internal dealings are not, however, recognised for the purposes of applying tax treaties outside the context of determining the profit attributable to the PE.1084 This means, for example, that the PE state is prevented from imposing source-based taxation on notional payments made by the PE to the rest of the enterprise. If treaty benefits are extended to PEs, effectively resulting in PEs being treated more like separate enterprises for treaty purposes, it seems reasonable to re-examine this non-recognition of notional payments.

The discussion below will focus on notional transactions involving interest and royalties to illustrate the main considerations associated with the recognition of notional payments for treaty purposes. It should be kept in mind, however, that notional interest payments can only be recognised for profit attribution purposes in limited circumstances and that such payments should only be recognised for the purposes of applying Article 11 or Article 12 if they are recognised for profit attribution purposes. Notional transactions can of course also involve other categories of income. Notional payments may occur from the PE to the head office, from the head office to the PE, or between PEs located in different states; the discussion below addresses each of these different types of payments in turn.

Note that references to the recognition of notional payments for treaty purposes in this section should be taken to refer to the recognition of such payments for treaty purposes other than profit attribution (i.e., for the application of the treaty after the profit attributable to the PE and to other parts of the enterprise has been determined).

9.3.2.1. Notional payments from the PE to the head office

A PE may be considered to make notional royalty payments to its head office for profit attribution purposes if, for example, the PE utilises intellectual property rights which are attributable to the head office.1085 Similarly, if the head office conducts treasury functions and the funding for the PEs operations includes a notional loan from the head office to the PE, then for profit attribution purposes, the PE may be considered to make notional interest payments to the head office.1086 Recognising such notional

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1080 The AOA is discussed in more detail in Chapter 5 (see Section 5.2.5.).
1081 OECD, "2010 Report…," Part I, Section B-3(v), para 35.
1085 See, for example: OECD, "2010 Report…," Part I, Section D-3(iv), para 241. For discussion regarding the attribution of intangible assets to different parts of an enterprise, see: OECD, "2010 Report …," Part I, Section D-2, paras 105-128. For discussion regarding the determination of the profits attributable to different parts of an enterprise in relation to intangible property, see: OECD, "2010 Report…," Part I, Section D-3(iv), paras 235-250.
1086 It is important to distinguish between the allocation of external interest to the PE and notional payments of interest from the PE to other parts of the enterprise. An allocation of external interest to the PE will not give rise to notional payments, since the PE will effectively be considered to have made the real payment to the third party. This gives rise to reverse PE triangular cases, which will be discussed in Chapter 11. Notional interest payments can only be recognised for profit attribution purposes where part of the entity conducts treasury functions, in this case the head office (see: OECD, "2010 Report…," Part I, Section D-2(v), para 153).
transactions as income received by the head office and paid by the PE for the purposes of applying the other articles of the R-PE treaty would be consistent with treating PEs as separate entities. This implies that the interest and royalties articles (Article 11 and Article 12) would apply to the notional payment and the PE state would be entitled to impose tax on the notional income in accordance with the maximum rates specified in those articles. Recognising notional payments for treaty purposes (beyond the attribution of income) and allowing source-based taxation to be imposed may also reduce the potential for treaty shopping though PEs, since it could limit the enterprise’s ability to make base eroding payments out of the PE without triggering a withholding tax liability in the PE state. This would depend, however, on the PE state actually imposing tax on the notional payments under its domestic law.

One of the main objections to allowing the PE state to impose source-based taxation on notional payments is that it would represent double taxation. In the residence state, such notional income is effectively taxed in the hands of the entity as a whole because such payments reduce the profit attributable to the PE and therefore reduce the amount in relation to which the residence state must grant relief (either exemption or credit). This is demonstrated in the following example.

**Example**

A resident of State R derives business profits of $100 which is attributable to a PE in State PE. Under the R-PE treaty, State R uses the exemption method as the primary method of relief. This situation is illustrated in the following diagram.

![Diagram of Example involving notional payments from PE to the head office]

The following table compares two alternative scenarios: (i) the PE makes a notional royalty payment of $90 to the head office or (ii) there is no notional royalty payment.

<table>
<thead>
<tr>
<th></th>
<th>(i) Notional royalty payment $90</th>
<th>(ii) No notional royalty payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit attributable to the PE:</td>
<td>101088</td>
<td>100</td>
</tr>
<tr>
<td>Taxable income in State R before exemption</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Less: Exemption of PE profit</td>
<td>(10)</td>
<td>(100)</td>
</tr>
<tr>
<td>Taxable income in State R</td>
<td>90</td>
<td>-</td>
</tr>
</tbody>
</table>

As can be seen in the table above, where the residence state uses the exemption method in relation to the income attributable to the PE, the taxable income in the residence state is effectively increased by the amount of any notional payments made by the PE, as a result of the reduction in the profit attributable to

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1087 Under Article 11 of the OECD Model, interest arising in one contracting state and beneficially owned by a resident of the other contracting state can be taxed in the state where it arises, but the tax that can be imposed is limited to 10% of the gross amount of the interest. Under Article 12 of the OECD Model, the source state is prevented from imposing tax on royalties, however, it is common for concluded treaties to allow the source state to impose tax up to a specified maximum rate based on the gross amount of the royalties (similar to the dividend and interest articles).

1088 The profit attributable to the PE is $100 less the notional royalty payment of $90: $100 - $90 = $10.
the PE. A similar effect can also be observed where the residence state uses the credit method, however, in that case the impact on the tax collected in the residence state will be influenced by the relative tax rates in the PE state and the residence state. The residence state could be thought of as exempting the "gross" profit attributable to the PE (i.e., before the notional payment to the head office, but net of other deductions) and then taxing the notional royalty payment. If the PE state is entitled to impose source-based taxation on notional payments, such payments are effectively subject to tax in both the PE state and the residence state. The relief for the tax imposed in the PE state on the profit attributable to the PE (whether it be an exemption or credit) is effectively not available in relation to the notional payments because, rather than being included in the profit attributable to the PE, they actually reduce the profit attributable to the PE. This suggests that if the PE state is entitled to impose withholding tax on notional interest and royalty payments made by the PE to the head office, then the residence state should be required to grant relief for the withholding tax imposed in the PE state.

Since the notional income is categorised as interest or royalties, as the case may be, the residence state should be required to grant relief using the credit method. Thus, although the income derived by the resident entity may be categorised as, e.g., business profits, it should effectively be recharacterized to recognise that the income which is being taxed in the residence state is not the business profits attributable to the PE, but rather, the notional interest or royalty payment received from the PE. This relief should be in addition to any relief available in relation to the profit attributable to the PE (whether exemption or credit), since exempting the profit attributable to the PE, or granting a credit for the tax imposed on the profit attributable to the PE, is not sufficient to prevent unrelieved double taxation where notional interest and royalty payments made by the PE to the head office are taxable on a source basis in the PE state.

The application of the R-PE treaty in a situation where the notional royalty payments from the PE to the head office are recognised for the purposes of applying Article 12 is illustrated in the following example.

**Example:** A resident of State R derives business profits of $100 which is attributable to a PE in State PE. The PE makes a notional royalty payment of $90 to the head office. Under the R-PE treaty, State R uses the exemption method as the primary method of relief, but uses the credit method for interest, royalties and dividends. Under its domestic law, the PE state imposes a withholding tax on notional royalty payments of 10%. The R-PE treaty limits source based taxation of royalties to 10% of the gross amount. The corporate tax rate in State R is 20% and the corporate tax rate in State PE is 30%. This situation is illustrated in the following diagram.

**Figure 9.8.: Example involving notional payments from the PE to the head office**

The following table compares two alternative scenarios: (i) the notional royalty payment of $90 is recognised for the purposes of applying Article 12 of the R-PE treaty or (ii) the notional royalty payment is not recognised for the purposes of applying Article 12.

<table>
<thead>
<tr>
<th></th>
<th>(i) Notional royalty payment recognised for Article 12</th>
<th>(ii) Notional royalty payment not recognised for Article 12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit attributable to the PE</td>
<td>10</td>
<td>10</td>
</tr>
</tbody>
</table>
The provision of relief in the residence state in relation to withholding tax imposed on notional payments in the PE state would ensure that there is no unrelieved double taxation in relation to such payments. It would require that, at least for treaty purposes, the income derived by the resident entity is considered to have the character of the notional payment received (e.g., interest or royalties) which may differ from the characterisation of the income initially received by that entity (e.g., business profits). This would result in the R-PE treaty being applied to notional payments between a PE and its head office in the same way as it would be applied to payments by a subsidiary resident in the PE state to its parent company resident in State R. This would be very complicated to apply, however, since it would require the residence state to first exempt the income attributable to the PE, or to provide credit relief for tax imposed on that income in the PE state, and then to grant credit relief in relation to the withholding tax imposed on the notional payment. Essentially, one item of income must be treated as two separate items of income.

### 9.3.2.2. Notional payments between PEs located in different states

The recognition of notional interest and royalty payments between PEs located in different states could potentially give rise to PE triangular cases in situations where they would not otherwise arise. Currently, a notional interest or royalty payment from one PE to another PE located in a different state

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1089 $100 x 30%. The profit attributable to the PE multiplied by the tax rate in the PE state.
1090 $100 x 30%. The profit attributable to the PE multiplied by the tax rate in the PE state.
1091 $90 x 10%. A withholding tax of 10% is imposed on the notional royalty of $90.
1092 The PE state is prevented from imposing withholding tax on the notional royalty payment by the terms of the R-PE treaty.
1093 $90 x 20% corporate tax rate in State R.
1094 $90 x 20% corporate tax rate in State R.
1095 Where the PE state is entitled to impose tax on the notional interest payment, the residence state should be obliged to grant relief. Since the credit method applies in relation to interest payments, even if the exemption method generally applies (at least under the relief provisions of the OECD Model), State R should be required to provide credit relief. The relief will be limited to the lesser of the withholding tax imposed in State PE (i.e., $9) and the tax imposed in State R (i.e., $90 x 20% = $18) in relation to the income. There is no credit for the other $3 of tax imposed in the PE state because the income attributable to the PE is exempt in the residence state.
1096 $12 in State PE and $9 in State R.
1097 $3 in State PE and $18 in State R.
1098 Notional payments could also potentially occur between two PEs located in a single state, but such payments do not give rise to questions of treaty recognition for notional payments so will not be discussed here.
reduces the profit attributable to the paying PE and increases the profit attributable to the recipient PE. If, however, the state where the paying PE is located is entitled to impose withholding tax on such payments in accordance with the terms of the treaty between the two PE states, then the income attributable to the recipient PE would effectively include income which has been taxed on a source basis in a third state (i.e., not the residence state or the PE state). This effectively gives rise to a typical PE triangular situation. In this case, the recipient PE state should be obliged to provide relief and the state where the paying PE is located should be required to apply the conditions of the treaty between the two PE states (i.e., equivalent to the PE-S treaty).

The following example demonstrates how the recognition of notional payments between PEs located in different states for treaty purposes may operate. In this example, the residence state uses the exemption method in relation to both PEs since, as discussed above, this is the only method which is consistent with treating PEs as separate entities for treaty purposes.

Example

A resident of State R derives business profits of $200, $100 of which is attributable to a PE in State S and $100 of which is attributable to a PE in State PE. The PE in state S makes a notional royalty payment of $90 to the PE in State PE. Under both the R-PE treaty and the R-S treaty, State R uses the exemption method as the primary method of relief, but uses the credit method for interest, royalties and dividends. Under its domestic law, State S imposes a withholding tax on notional royalty payments of 20%. The PE-S treaty limits source based taxation of royalties to 10% of the gross amount. The corporate tax rate in State S is 20% and the corporate tax rate in State PE is 30%. This situation is illustrated in the following diagram.

Figure 9.10: Example showing notional payments between two PEs

The following table compares two alternative scenarios: (i) the notional royalty payment of $90 is recognised for the purposes of applying Article 12 of the PE-S treaty or (ii) the notional royalty payment is not recognised other than for profit attribution purposes.

<table>
<thead>
<tr>
<th></th>
<th>(i) Notional royalty payment recognised for Article 12</th>
<th>(ii) Notional royalty payment not recognised for Article 12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit attributable to the PE in State S (after deduction for notional royalty)</td>
<td>101099</td>
<td>101100</td>
</tr>
<tr>
<td>Tax imposed in State S on profit attributable to the PE (20%)</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>State S withholding tax on notional royalty payment</td>
<td>91101</td>
<td>-</td>
</tr>
</tbody>
</table>

1099 Business profits of $100, less notional royalty payment of $90: $100 - $90 = $10
1100 Business profits of $100, less notional royalty payment of $90: $100 - $90 = $10
1101 The notional royalty of $90 is subject to withholding tax of 10%: $90 x 10% = $9
As can be seen in the table above, where the residence state uses the exemption method in relation to the profit attributable to both the PEs, the imposition of source-based taxation on notional payments between PEs located in different states does not have any impact on the tax collected in the residence state. This may not be the case if the residence state uses the credit method. More broadly, however, the main impact of recognising notional payments between two PEs for treaty purposes, and thus allowing the state of the paying PE to impose withholding tax, would be on the split of revenue between the two PE states. It would essentially result in the state where the paying PE is located collecting more tax in relation to the activities conducted by the PE.

9.3.2.3. Notional payments from the head office to the PE

Notional payments from the head office to a PE should arguably be treated in the same way for treaty purposes as other income arising in the residence state and attributable to the PE, and should therefore only be recognised for treaty purposes if such other income is also recognised. The potential application of the R-PE treaty to such income was discussed in detail above (see Section 9.3.1.), and similar issues would arise if notional payments from the head office to the PE were recognised.

9.3.2.4. Notional profit distributions by the PE

If notional payments between different parts of the enterprise are recognised for treaty purposes, the question arises as to whether the PE should be considered to make notional profit distributions (i.e., dividends) and whether such distributions should be subject to withholding tax in the PE state. This would give rise to extremely difficult issues regarding the situations in which a PE should be deemed to make a profit distribution and how the amount of such notional distributions should be determined. It would also likely give rise to economic double taxation similar to that which exists where the profits derived by a company are taxed in that company’s residence state when they are received and are then effectively taxed again when the profits are distributed to shareholders in the form of dividends. Further discussion of the potential recognition of notional profit distributions by PEs is beyond the scope of this thesis.

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1102 Business profits of $100, plus notional royalty payment of $90: $100 + $90 = $190
1103 Business profits of $100, plus notional royalty payment of $90: $100 + $90 = $190
1104 $190 x 30% = $57
1105 $190 x 30% = $57
9.3.2.5. Conclusions

Recognising notional payments between different parts of an enterprise for treaty purposes beyond determining the profit attributable to a PE would be consistent with treating the PE in the same way as a resident enterprise for treaty purposes. It would result in the state where the income arises (e.g., the PE state) being entitled to impose source-based taxation on notional payment in accordance with the terms of the treaty between that state and the state where the part of the enterprise receiving the income is located (whether that be the residence state or another PE state). In addition, in order to prevent double taxation, the state where the part of the enterprise receiving the notional income is located should be obliged to provide relief (e.g., for withholding tax imposed on the notional payment). Taxation of notional payments made by PEs would tend to limit the opportunities for lowering the overall tax burden through base eroding payments, and thus may tend to limit the opportunities for treaty shopping. The main problem with recognising notional payments for treaty purposes is that it would be extremely complicated to apply in practice. It is also necessary for resolving the issues that arise in PE triangular cases and its main impact would be felt in bilateral cases, which represent the vast majority of situations involving PEs. For these reasons, the recognition of notional payments is something which could be considered further, but it would not be a necessary consequence of applying the PE-S treaty in PE triangular cases.

9.4. Conclusions

This chapter has addressed a number of specific issues which should be addressed if the PE-S treaty is made to apply in PE triangular cases, including the resolution of multilateral disputes through the mutual agreement procedure, the application of threshold requirements in tax treaties, and the extent to which treaty benefits can be extended to PEs of insurance companies, given that investment income is allocated to such PEs on the basis of the insurance risks assumed by the PE. The application of Article 6, in relation to income from immovable property, should also be considered further. In addition, PEs should be prevented from claiming treaty benefits under the PE-S treaty in relation to income which, while it may be attributable to the PE, cannot be taxed in the PE state under the terms of the R-PE treaty.

If PEs are effectively treated as separate enterprises for the purposes of claiming benefits under treaties concluded with third states, the question also arises as to how far this separate entity treatment should be taken. That is, whether the PE should be treated as a separate treaty-eligible entity for the purposes of the R-PE treaty and, in addition, whether notional payments between different parts of the enterprise should be recognised for treaty purposes, thus allowing states to impose source-based taxation on such notional payments. For the purposes of resolving the issues arising in PE triangular cases, it would not be necessary to take the separate enterprise treatment of PEs to this logical conclusion and it would be extremely complicated to implement and apply in practice. In addition, the vast majority of cases involving PEs are bilateral cases and it is in these cases, rather than in triangular cases, where the main impact of such an approach would be felt. However, if PEs are treated as separate entities for profit attribution purposes and for the purposes of treaties with third states, the extent to which PEs should be treated as separate entities more generally for treaty purposes is clearly something that should be considered further.