Triangular cases: The application of bilateral tax treaties in multilateral situations
Fett, E.E.

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Chapter 10
Dual resident triangular cases

10.1. Introduction
Dual resident triangular cases occur where a person\textsuperscript{1106} who is considered to be resident in two different states under their respective domestic laws receives income from sources in a third state (the "source state").\textsuperscript{1107} Dual residence may occur where the residence rules of the two states differ and take into account different factors for determining residence or, alternatively, where the residence rules of both states are similar, but where the factor upon which residence is based is split between different states. Dual residence can occur, for example, where an individual lives for part of the year in each of two different states or, in the case of a company, where the company is incorporated in one state and is managed in another or has its management split between various locations. Tax treaties contain tie-breaker rules to assign residence for treaty purposes however, as will be seen below, these rules may not be effective for resolving the issues that arise in dual resident triangular cases.

A dual-resident triangular case is illustrated in the following diagram (in this diagram the source state is labelled “State S” and the residence states are each labelled “residence state”).

Figure 10.1.: Dual resident triangular case.

There are three treaties which are potentially applicable in this situation; the first is the treaty between the two residence states and the other two are the treaties between the two residence states and the source state. Due to the bilateral nature of tax treaties, and as a consequence of the fact that residence for treaty purposes depends on residence under domestic laws, residence must be determined independently for each treaty. In dual-resident triangular cases, therefore, where a person is resident in two states under their respective domestic laws, that person will generally also be resident in both those states for the purposes of the treaties which each of them have concluded with third states.\textsuperscript{1108} As a result, the source state in a dual resident triangular case may be subject to the provisions of two separate treaties, in which case it will only be able to satisfy its treaty obligations by applying the terms of the treaty that are most favourable to the taxpayer.\textsuperscript{1109} This gives rise to concerns regarding the potential for tax avoidance.

\textsuperscript{1106} The term "persons" is defined in Article 3(1) to include "...an individual, a company and any other body of persons." The discussion in this chapter will refer only to individuals and companies; it does not address any issues associated with partnerships and/or hybrid entities.


\textsuperscript{1108} See, inter alia: Avery Jones, J.F., & Bobbett, C., "Triangular Treaty Problems..."; Avery Jones, J.F., "The Interaction Between Tax Treaty..." at p. 137 (Chapter 6, Section 6.4.1.); Gusmeroli, M., "Triangular Cases... Part 1."

through improper use of treaties. That is, a company could be incorporated in one state and effectively managed from another, making it a dual resident, in order to take advantage of the treaties between those two residence states and a third state (the source state). Of particular concern is the possibility for the dual-resident company to claim a reduction in source based taxation under the treaty between the losing residence state (State B) and the source state (the B-S treaty) in situations where the treaty between the two residence states prevents the losing residence state from imposing any tax on the income.

The OECD Commentary takes the position that a company whose residence has been allocated to one state (i.e., State A) under a tax treaty will not be resident of the losing residence state (State B) for the purposes of treaties with third states (i.e., the B-S treaty), on the basis of the second sentence of Article 4(1).1110 The second sentence of Article 4(1) provides that: "This term [i.e., 'resident of a Contracting State'], however, does not include any person who is liable to tax in that state in respect only of income from sources in that state..." The OECD Commentary takes the view that, as a result of the terms of the treaty between the two residence states, a person whose residence has been assigned to one state (the winning residence state or “State W”) under the treaty between those two states will only be subject to tax in the state to which residence is not assigned (the losing residence state or “State L”) on income from sources in that state, and will therefore not be resident in that state (State L) under Article 4(1) of treaties with third states (i.e., the L-S treaty). As a result, the dual resident would only be able to claim the benefit of treaties concluded by the wining residence state and would not be able to claim dual treaty benefits in third (source) states. This issue will be discussed in detail in Chapter 11.

This chapter will first give a general overview of the types of residence rules that are commonly found in domestic law and of the residence tie-breaker rules in tax treaties before moving on to consider the application of tax treaties in various types of dual resident triangular cases. Please note that this chapter gives only a brief outline of the issues that can arise in the application of the residence tie-breaker rules of tax treaties. These issues have been discussed at length elsewhere,1111 and are not specific to dual resident triangular cases; they arise equally in bilateral situations involving dual residents.

10.2. Residence under domestic laws

Different states employ different criteria for determining whether a certain person is resident for tax purposes. Where these criteria overlap, a person may be considered to be resident in two states under their respective domestic laws and thus may be a dual resident. This section will give a brief overview of the residence rules that are typically applied in relation to individuals under domestic laws, before turning to the domestic residence rules typically applied to companies.

10.2.1. Individual residence under domestic laws

Various tests are employed by different countries to determine the residence of individuals. The basic idea behind the residence concept is that the person involved has close economic and personal ties to the state.1112 In the case of individuals, therefore, residence is often determined using a "facts and circumstances approach" whereby an individual’s residence is determined on the basis of their personal

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1112 Vann, R., "International Aspects...," at p. 729.
and economic connections to the state. In applying this type of an approach, various factors may be taken into account, such as whether the person has a permanent home within the jurisdiction, the extent to which they have family or other personal ties, or the extent to which they engage in income-producing activities in the country. In addition to a facts and circumstances approach (or as an alternative), many countries use a more objective residence test. It is common, for example, for domestic legislation to include a residence test based on physical presence, whereby a person is considered to be a resident if they spend more than 183 days in the country in a particular tax year or in any 12 month period. Objective residence tests for individuals may also be based on visa and immigration status, domicile, nationality or citizenship. Clearly the factors used to determine residence in different states can overlap, such that an individual is considered to be resident under the domestic laws of two states. This is most likely to occur in situations where an individual splits their time between two different states, for example, where they live close to an international border and have their home in one state but work in the other.

10.2.2. Corporate residence under domestic laws

The specific criteria for determining whether a corporate entity is resident differ substantially between countries, however they generally fall into two broad categories; formal tests based on legal factors (such as the place of incorporation) and factual tests based on economic or business factors (usually the place of management). In countries that employ both legal and economic factors as residence criteria they are usually alternate tests, such that meeting the conditions of one test makes the company a resident even if the conditions of the other are not satisfied.

Formal tests of company residence may refer to the place of incorporation or registration, the domicile of the company, or the location of the company's registered office or legal "seat". The basic principle behind these formal tests is that companies exist only as a result of their formation under the laws of a particular country, and therefore companies formed in a particular country (or having their main legal ties to a particular country) are generally deemed to have a sufficient connection to that country to justify residence-based worldwide taxation.

The factual or business tests applied in different countries use varying criteria to determine residence, however most ultimately refer in some way to the place where management functions are performed. For example, in some common law countries (such as the UK and Canada) a company is resident in the place where its central management and control is located. Central management and control refers to the highest level of management in the company, generally exercised by the board of directors. Many other jurisdictions also refer to the highest level of strategic management of the company, while some refer to a lower level of day-to-day management. In general, the place of management is a question of fact and

1113 Vann, R., "International Aspects…," at p. 729.
1116 Arnold, B.J., & McIntyre, M.J., International Tax Primer, at pp. 17-18; Vann, R., "International Aspects…," at p. 730. Vann notes that the only major country that uses citizenship as a test for imposing worldwide taxation is the US.
1117 De Broe, L., "Corporate Tax Residence in Civil Law Jurisdictions" bound in Maisto, G., (Ed.), Residence of Companies Under Tax Treaties and EC Law. (Amsterdam: IBFD Publications, 2009), at p. 96 (Section 4.2.1.).
1118 Miller, A., & Oats, L., Principles of International Taxation, Second Edition, (Haywards Heath: Tottel Publishing Ltd, 2009), at p. 54; De Broe, L., "Corporate Tax Residence…." at p. 96 (Section 4.2.1.).
1119 Behrens, P., "General Principles on Residence of Companies: A Comparative Analysis of Connecting Factors Used for the Determination of the Proper Law of Companies," bound in Residence of Companies Under Tax Treaties and EC Law: (Amsterdam: IBFD Publications, 2009), at p. 8 (Section 1.2.2.1.).
1120 Miller, A., & Oats, L., Principles of International Taxation, at p. 54-57.
1122 De Broe, L., "Corporate Tax Residence…," at p. 102-7 (Section 4.5.1);
courts tend to apply a substance over form approach, carefully examining who, in reality, manages the company within the meaning of the relevant domestic rules.\footnote{Couzin, R., \textit{Corporate Residence}…, at p. 44-45 (Section 2.2.2.6); De Broe, L., \textit{"Corporate Tax Residence…,"} at p. 109 (Section 4.5.2.).} It is possible for the management of a company to be split between more than one place, which can result in the company being treated as a resident taxpayer under the domestic laws of more than one jurisdiction. For example, board meetings could be held in different locations throughout the year or directors could attend board meetings from different locations using teleconferencing facilities. In a similar vein, dual residence can arise as a result of two countries having overlapping residence rules, for example where they look at different levels of management to determine residence. Clearly, dual residence can also occur if a company is incorporated in one state but has its place of management in another.

\section*{10.3. Residence under tax treaties}

For treaty purposes, residence is determined in accordance with Article 4(1) (or its equivalent) by reference to residence under domestic laws. Article 4(1) provides as follows:

“For the purposes of this Convention, the term ‘resident of a Contracting State’ means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.”

There are a number of issues associated with applying this provision to determine who is resident for treaty purposes,\footnote{For discussion of these issues see, inter alia: Couzin, R., \textit{Corporate Residence}…; Maisto, G., (Ed.), \textit{Residence of Companies}….} however, the important point to note here is that a person who is resident in two states under their respective domestic laws will generally also be a dual resident for treaty purposes. To deal with such situations, Article 4 contains tie-breaker rules which are intended to assign the residence of a dual resident person to one of their residence states for the purposes of the treaty between those two states.\footnote{The tie-breaker rule applicable to individuals is contained in Article 4(2). The tie-breaker rule applicable to persons other than companies is contained in Article 4(3).} However, as will be seen below, the applicable tie-breaker rule may not always be effective in assigning residence to a particular state and the person involved may continue to be a dual-resident for the purposes of the treaty. This can potentially lead unrelieved double taxation both in bilateral and multilateral situations.

\subsection*{10.3.1. Residence tie-breaker rules for individuals}

Where an individual is resident in two states for domestic law purposes and thus for the purposes of the tax treaty between those two states (under Article 4(1)), the residence tie-breaker provision of Article 4(2) applies. Under this provision, the individual's residence for the purposes of the treaty will be determined as follows:

"a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available in both States, he shall be deemed to be a resident only of the state with which his personal and economic relations are closer (centre of vital interests);

b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either state, he shall be deemed to be a resident only of the State in which he has an habitual abode;

c) if he has a habitual abode in both States, or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;
d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement."

Thus, the residence tie-breaker for individuals contains a hierarchy of tests; if the first test does not settle the question, then the next test should be applied and so on until the person's residence has been settled or until the contracting states are required to determine the individual's residence for treaty purposes by mutual agreement.

The first residence tie-breaker test for individuals assigns residence to the State where the individual "has a permanent home available to him." The existence of a "home" implies some kind of "emotional and family link" to the accommodation.\(^\text{1126}\) Permanence requires that the home is available continuously or for permanent use, in contrast to being available only temporarily or for occasional short stays,\(^\text{1127}\) and does not require that the person intends to live there forever.\(^\text{1128}\) In broad terms, a home will be available if it is owned or rented by the individual and they are able to access it.\(^\text{1129}\) The application of the permanent home test will often be quite straight-forward and it will effectively assign residence to one state,\(^\text{1130}\) however difficulties may arise in some cases, for example, in determining whether a holiday home or some other kind of secondary home should be considered a permanent home.\(^\text{1131}\)

If the individual has a permanent home available to them in both contracting states, then the next factor to consider is with which state their personal and economic relations are closer (their "centre of vital interests").\(^\text{1132}\) This test is a facts and circumstances test, which requires an examination of the individuals connection to each state.\(^\text{1133}\) In determining a person's the centre of vital interests, the OECD Commentary states that "regard will be had to his family and social relations, his occupations, his political, cultural or other activities, his place of business, the place from which he administers his property, etc."\(^\text{1134}\) Where an individual has closer personal relations with one state and closer economic relations with the other, the personal relations will often be given more weight for the purposes of applying the test, although practice varies between countries\(^\text{1135}\) and there should in fact be an evaluation of the individuals circumstances as a whole.\(^\text{1136}\)

Where a dual-resident individual does not have a permanent home in either contracting state, or if their centre of vital interests cannot be determined, the habitual abode test will apply. The main question regarding the application of this test is whether it should be applied simply by considering the amount of time spent in each state, or whether something else is required.\(^\text{1137}\) The OECD Commentary states that where a person has a permanent home in both states (but where the centre of vital interests cannot be

\(^{1126}\) Avery Jones, J.F., et al., "Dual Residence...", at p. 24; Vogel, K., Engelschalk, M., & Görl, M., Klaus Vogel on Double Tax Conventions..., at p. 247, (m.no. 70).

\(^{1127}\) OECD Commentary on Article 4, para 13; Avery Jones, J.F., et al., "Dual Residence...", at p. 25; Vogel, K., Engelschalk, M., & Görl, M., Klaus Vogel on Double Tax Conventions..., at p. 247, (m.no. 71).

\(^{1128}\) Avery Jones, J.F., et al., "Dual Residence...", at p. 25;

\(^{1129}\) OECD Commentary on Article 4, para 13;

\(^{1130}\) Stuart, E., "Art. 4(2) of the OECD Model Convention: Practice and Case Law," bound in Residence of Individuals under Tax Treaties and EC Law, (Amsterdam: IBFD, 2010), pp. 181-194 at p. 184 (Section 9.3.).

\(^{1131}\) Sasseville, J., "History and Interpretation of the Tiebreaker Rule in Art. 4(2) of the OECD Model Tax Convention," bound in Maisto, G. (Ed.), Residence of Individuals under Tax Treaties and EC Law, (Amsterdam: IBFD, 2010), pp. 153-166 at pp. 164-165 (Section 7.3.).

\(^{1132}\) An individual's centre of vital interests is not considered unless the person has a permanent home in both states. Avery Jones et al. state that this is presumably because if a person does not have a permanent home in either state, then they would be unlikely to have their centre of vital interests in either state; in such cases it would be pointless to apply this test and thus one jumps to the habitual abode test (see: Avery Jones, J.F., et al., "Dual Residence...", at p. 104).

\(^{1133}\) Baker, P., "The Expression 'Centre of Vital Interests' in Art. 4(2) of the OECD Model Convention," bound in Maisto, G. (Ed.), Residence of Individuals under Tax Treaties and EC Law, (Amsterdam: IBFD, 2010), pp. 167-180 at pp. 174-175 (Section 8.3.4.).

\(^{1134}\) OECD Commentary on Article 4, para 15.

\(^{1135}\) Avery Jones, J.F., et al., "Dual Residence...", at pp. 106-110; Baker, P., "The Expression...", at pp. 178-179 (Section 8.3.7.).

\(^{1136}\) Vogel, K., Engelschalk, M., & Görl, M., Klaus Vogel on Double Tax Conventions... at pp. 250-51, (m.no. 75-75e).

\(^{1137}\) Sasseville, J., "History and Interpretation...", at p. 165 (Section 7.3.).
determined), the habitual abode test will "tip the balance to the state where he stays more frequently." However, the test should generally not be applied by simply comparing the number of days spent in each state and allocating residence to the state where the individual has spent more time during the period under consideration; this follows from the next paragraph of the tie-breaker which indicates it is possible for an individual to have a habitual place of abode "in both states or in neither of them". Where an individual does have a permanent home available in both states, that person’s place of habitual abode will should be determined as the place where they normally live. Where the individual does not have a permanent home in either state, they may still be considered to have a habitual abode in one of the states on the basis of a number of stays, e.g., in different hotels.

If the person’s habitual abode cannot be determined, they will be considered to be resident in the state of which they are a national. In relation to individuals, the term "national" is defined in Article 3(2) of the OECD Model to mean "any individual possessing the nationality or citizenship" of the state in question. Ultimately, unlike the other concepts used in the tie-breaker rule (permanent home, centre of vital interests, habitual abode), which should generally be given an international meaning, nationality must be determined under domestic laws. The application of the nationality test should not generally give rise to any difficulties since an individual’s nationality will usually be quite clear.

If an individual’s residence has still not been assigned to one of the contracting states after the application of the nationality test, the contracting states are required to determine that person’s residence by mutual agreement. This provision differs from the normal application of the mutual agreement procedure in that it imposes a positive obligation on the states to reach a conclusion ("shall settle the matter" rather than "shall endeavour... to resolve the case"). However, there is no time limit imposed on the contracting states and it may take a number of years before they are able to reach an agreement. Furthermore, it is not clear that there is any way of forcing the states to come to an agreement or of solving the situation if they fail to agree, although this may be remedied if Article 25 of the treaty contains a binding arbitration provision (provided that provision also applies where the mutual agreement procedure is initiated under Article 4).

### 10.3.2. Residence tie-breaker rules for companies

Where a company is resident in both contracting states under Article 4(1), the tie-breaker test in Article 4(3) applies to determine the residence of the company for the purposes of the treaty. Article 4(3) deems a dual-resident company to be resident only in "the State in which its place of effective management is situated." However, the interpretation of the term "place of effective management" is not always clear and this test can be extremely difficult to apply in practice. This section will first discuss the

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1138 OECD Commentary on Article 4, para 17.
1139 See OECD Model, Article 4(1)(c); Sasseville, J., "History and Interpretation..." at p. 166 (Section 7.3).
1140 Vogel, K., Engelschalk, M., & Görl, M., Klaus Vogel on Double Tax Conventions..., at pp. 252-253, (m.no. 78).
1141 OECD Commentary on Article 4, para 18; Vogel, K., Engelschalk, M., & Görl, M., Klaus Vogel on Double Tax Conventions..., at p. 253, (m.no. 79).
1142 See, inter alia: Avery Jones, J.F., et al., "Dual Residence..." at pp. 19-22; Sasseville, J., "History and Interpretation..." at p. 162 (Section 7.3).
1143 Avery Jones, J.F., et al., "Dual Residence..." at p. 20; Vogel, K., Engelschalk, M., & Görl, M., Klaus Vogel on Double Tax Conventions..., at p. 253, (m.no. 81).
1144 OECD Model, Article 25(2). Note that an individual could also invoke the mutual agreement procedure directly under Article 25 if the contracting states fail to agree on the application of one of the earlier tie-breaker rules (for further discussion, see: Stuart, E., "Art. 4(2) of the...").
1146 A binding arbitration provision was introduced into Article 25 in the 2008 update of the OECD Model (see Article 25(5)).
1147 Vogel states that mutual agreement under Article 4(2) is "reached by application of the procedural rules of Art. 25" indicating that the arbitration procedure should apply also for the purposes of reaching a mutual agreement under Article 4(2) (provided the treaty contains an arbitration clause). See: Vogel, K., Engelschalk, M., & Görl, M., Klaus Vogel on Double Tax Conventions..., at p. 254, (m.no. 82).
1148 Article 4(3) applies to a "person other than an individual" but, for ease of expression, the discussion in this section will refer solely to companies.
interpretation and application of the tie-breaker provision based on the "place of effective management" and will then go on to discuss alternative tie-breaker provisions which are included in some treaties.

10.3.2.1. Place of effective management

The OECD Commentary to Article 4 states that the place of effective management is "the place where the key management and commercial decisions" are made.1149 However, there is no common agreement on the level of management which the tie-breaker is referring to and different states interpret the term differently, commonly influenced by the tests which are found in their domestic laws.1150 States that have inherited residence concepts based on the UK common law "central management and control" concept, for example, tend to view the place of effective management as referring to management by the board of directors.1151 The other most common interpretation is that the place of effective management is located in the place where senior management operates, however other interpretations are also possible.1152 Differing interpretations of the term "place of effective management" can clearly give rise to significant difficulties in applying it as a residence tie-breaker.

Even if the two contracting states do agree on the interpretation of the term "place of effective management," it may not be possible to determine where the place of effective management of a particular company is located, particularly where the company is managed in a decentralized way and management activities are split between different states. This could occur, for example, if the place of effective management is based on the activities of the board of directors, but board meetings are held in different locations throughout the year or board members attend meetings from different locations using teleconferencing facilities.1153 Senior management activities may also be conducted in a similar way, with senior executives located in different states, travelling frequently and communicating electronically. The OECD Commentary states that an entity "can only have one place of effective management at any one time."1154 but this does not mean that it will always be possible to identify exactly where that place of effective management is.

Where the place of effective management cannot be identified, Article 4(3) of the treaty between the two residence states would not be effective in allocating the residence of the company to one state for the purposes of the treaty. In this case, the person involved may invoke the mutual agreement procedure under Article 25. However, Article 25 requires only that the competent authorities "shall endeavour... to resolve the case"; it is possible that they will not be able to come to an agreement. In addition, it may be that the place of effective management is located in a third state, in which case the tie-breaker rule will not be effective in assigning residence to one of the contracting states.1155 If this is the case, it is difficult

1149 OECD Model Commentary to Article 4, para 24.
Avery Jones, J.F., "Place of Effective Management..."; Avery Jones, J.F., "2008 OECD Model..." Avery Jones notes that "The real problem with place of effective management is that there is a great tendency for states to consider that it is the same as their domestic law test, particularly when domestic law uses the same or a similar term" (at p. 186). Historically, there has also been little agreement on the meaning of the term (as outlined by Sasseville and Avery Jones in the articles referred to above).
1151 Sasseville, J., "The Meaning of...", at p. 295 (Section 9.6.). In 2000, wording was introduced into the OECD Model which seemed to support this view. It stated that: "The place of effective management will ordinarily be the place where the most senior person or group of persons (for example a board of directors) makes its decisions." (2000 OECD Commentary on Article 4, para 24). However, this wording was removed in the 2008 update of the OECD Model and Commentary; Sasseville notes that this was probably because it was concluded that the Commentary had gone to close to concept of "central management and control" (at p. 294). Sasseville goes on to say "What is left is a rather general statement that can support both the 'management of the top-level executives' view and the 'management by the board of directors' view." (at p. 295).
1153 Van Weeghel, S., "The Tie-Breaker Revisited...".
1154 OECD Commentary to Article 4, para 24.
1155 Couzin, R., Corporate Residence..., at p. 168 (Section 3.2.2.1.). Couzin suggests that, on the plain wording of Article 4(3), the company may not be resident in either contracting state for the purposes of the treaty, since the tie-breaker
to see how the question of residence could be resolved under the mutual agreement procedure, since it is not a question of the treaty being improperly applied or of taxation being imposed "other than in accordance with the Convention" but rather, of the terms of the convention failing to resolve the conflict. Ultimately, the place of effective management tie-breaker rule may not be effective in some cases in assigning the company's residence to one state for the purposes of the treaty between the two residence states, and dual residence may persist.

10.3.2.2. Alternative tie-breaker rules

The concerns and issues associated with applying the place of effective management test have led to the development of certain alternative tie-breaker rules. Couzin identifies four broad categories of tie-breaker rules adopted in bilateral tax conventions:

1. Factual tests – based on the place of effective management or some similar criterion.

2. Legal tests – such tests generally refer to the place of incorporation, creation or registration of the company.

3. "Best efforts" rule – where there is no specific tie-breaker as such, but rather, where the contracting states determine the residence of the dual-resident through mutual agreement.

4. Sequential tests – where the tie-breaker includes multiple sequential tests (based on the three categories specified above), similar to the approach used in the tie-breaker for individuals.

The discussion in this section will focus on tie-breaker rules based on mutual agreement between the contracting states and those based on legal tests, and will also briefly address the alternative of including sequential tests.

Mutual agreement

The OECD Commentary suggests an alternative provision to Article 4(3), whereby the residence of dual-resident companies would be determined on the basis of a mutual agreement between the contracting states. The suggested provision reads as follows:

"Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States."

1156 Couzin, R., Corporate Residence..., at pp. 166-167 (Section 3.2.1.);
1157 Couzin identifies the following alternative expressions: place of general management, centre of its administrative of practical management, actual centre of management, where the company is managed and controlled, and real organ of management (Couzin, R., Corporate Residence..., at p. 166 (Section 3.2.1.)). However, based on key word searches of IBFD's tax treaty database, these terms do not seem to be commonly used.
1158 Couzin notes that it is not clear whether tie-breakers that adopt "head office" or "headquarters" are meant to establish a factual or legal test, and that this could depend on the law of the treaty partners if these terms are used domestically (Couzin, R., Corporate Residence..., at p. 166 (Section 3.2.1.)).
1159 2010 OECD Commentary on Article 4, para 24.1.
1160 2010 OECD Commentary on Article 4, para 24.1.
Similar provisions are included in a number of concluded treaties\textsuperscript{1161} and Sasseville notes that the mutual agreement tie-breaker was not created by the OECD, but "merely reflects provisions that are increasingly included in bilateral tax treaties."\textsuperscript{1162} Under such provisions, the residence of a dual resident company is determined by the contracting states through mutual agreement, taking into account various factors. The main difficulty with this approach is that it relies on the contracting states reaching an agreement in circumstances where both states may be highly reluctant to concede that the company should be treated as a resident of the other contracting state for the purposes of the treaty.\textsuperscript{1163}

In addition, and perhaps more importantly, this provision is based on the premise that the dual resident will initiate the mutual agreement procedure. This is perhaps not an unrealistic assumption in most cases, since unless a mutual agreement is reached the person involved cannot claim treaty benefits in either state (as a result of specific wording included the provision) and may be subject to double taxation.\textsuperscript{1164} In certain situations, however, the dual resident may not have any incentive to initiate the mutual agreement procedure to resolve the question of its residence. In fact, the lack of a resolution may even be beneficial in certain triangular situations provided that double taxation can be avoided in the residence states (e.g., due to the application of domestic relief provisions).\textsuperscript{1165} That is, by not initiating the mutual agreement procedure to resolve the question of its residence, the dual resident may be able to ensure its continued eligibility under treaties concluded by both its residence states with third states from which it derives income.\textsuperscript{1166} This is clearly a weakness of the mutual agreement tie-breaker, particularly since there seems to be no authority for the contracting states to conclude an agreement in the absence of a request from the taxpayer.\textsuperscript{1167}

**Incorporation and other formal criteria**

The OECD Commentary dismisses the approach of resolving the dual-residence of companies by reference to registration on the basis that it is a "purely formal criterion."\textsuperscript{1168} However, a formal criterion such as incorporation or registration does have the distinct advantage that it would be simple to apply, at least in the vast majority of cases,\textsuperscript{1169} and would uniquely attach a company to a single jurisdiction, thus preventing situations where residence would not be assigned to either state for the purposes of the treaty.\textsuperscript{1170} Several states have in fact made reservations on the tie-breaker rule in Article 4(3), whereby they have reserved the right to use an alternative tie-breaker rule for corporate residence in their tax treaties.
based on more formal criteria. Those alternative criteria include the "place of incorporation or organisation" (Canada), the "registered office" (Turkey), and the "place of incorporation" (US).\footnote{1171}

One specific issue which must be dealt with where the treaty includes a tie-breaker based on incorporation is situations involving companies incorporated in third states. In their reservations to the OECD Commentary, Canada and the US have also reserved the right to deny dual-resident companies certain benefits under tax treaties if the place of incorporation (or organisation) does not result in an effective allocation of residence.\footnote{1172} As an alternative to the complete denial of treaty benefits, however, it would perhaps be preferable to supplement the main tie-breaker with a provision establishing how residence will be determined where the state of incorporation etc. is not located in either of the contracting states.\footnote{1173}

Sequential tests

Some treaties contain sequential tests for determining the treaty residence of dual-resident companies.\footnote{1174} Such provisions may, for example, treat the company as a resident of the state in which it is incorporated and, if it is not incorporated in either state, may treat the company as a resident of the state where its place of effective management is located (or vice versa, i.e., the first test may refer to place of effective management and the second may refer to incorporation).\footnote{1175} These two sequential tests may be supplemented by a mutual agreement tie-breaker, or alternatively, there may be only one test (either based on incorporation or management) supported by a mutual agreement provision.\footnote{1176} Sequential tie-breaker rules significantly reduce the likelihood that a residence conflict will not be resolved.\footnote{1177}

Conclusions

The difficulties with applying the "place of effective management" tie-breaker rule mean that there are likely to be situations where the residence of a dual-resident company cannot be assigned to one state for the purposes of the treaty between its two residence states. This would clearly be problematic in both bilateral and multilateral situations and indicates that it may be preferable to use an alternative tie-breaker rule. The use of an alternative tie-breaker based on the contracting states determining the residence of a dual resident by mutual agreement, however, may potentially lead to other problems in situations where the dual resident derives income from third states. This will be discussed in more detail below (see Section 10.4.4.).

\footnote{1171} 2010 OECD Commentary on Article 4, paras 27-32. In addition, Korea and Japan reserve the right to use the "head or main office" as the tie-breaker rule for companies in their treaties.
\footnote{1172} The reservation made by the US is reflected in Article 4(4) of the 2006 US model treaty, which reads as follows: "Where by reason of the provisions of paragraph 1 a company is a resident of both the Contracting States, then if it is created or organized under the laws of one of the Contracting States or a political subdivision thereof, such company shall be deemed to be a resident of the first-mentioned Contracting State. In all other cases involving dual resident companies, the competent authorities of the Contracting States shall endeavour to determine the mode of application of the Convention to such company. If the competent authorities do not reach such an agreement, that company will not be treated as a resident of either Contracting State for purposes of its claiming any benefits provided by the Convention."
\footnote{1173} Van Weeghel, S., "The Tie-Breaker Revisited...," at p. 967.
\footnote{1174} Couzin, R., Corporate Residence..., at pp. 177-178 (Section 3.2.5.). A series of sequential tests was also proposed by the Technical Advisory Group on Monitoring the Application of Existing Treaty Norms for the Taxation of Business Profits ("TAG") in a draft report published in 2001 (titled "The Impact of the Communications Revolution on the Application of 'Place of Effective Management' as a Tie Breaker Rule"), however these proposals were not implemented. For discussion, see: Hinnekens, L., "Revised OECD-TAG Definition of Place of Effective Management in Treaty Tie-Breaker Rule," 31 Intertax 10, (2003), pp. 314-319.
\footnote{1175} Couzin, R., Corporate Residence..., at pp. 177-178 (Section 3.2.5.).
\footnote{1176} Couzin, R., Corporate Residence..., at pp. 177-178 (Section 3.2.5.).
\footnote{1177} Couzin, R., Corporate Residence..., at pp. 177-178 (Section 3.2.5.).
10.4. Application of tax treaties in dual resident triangular cases

This section deals with the application of tax treaties in various types of dual resident triangular cases. It deals firstly with situations where there is no effective allocation of residence under the tie-breaker rule of the treaty between the two residence states, before moving on to deal with situations where residence is assigned to one of the residence states (the winning residence state, or “State W”) for the purposes of that treaty. For situations where residence is assigned to one state, the analysis is further split into two parts; the first considering situations where there is no PE in the state to which residence is not assigned (the losing residence state, or “State L”) and the second considering situations where the income is attributable to a PE in the losing residence state.

Scope and assumptions

In a dual-resident triangular case, in the absence of any applicable tax treaties, tax may be imposed on a residence basis in both residence states and on a source basis in the source state. It may not always be the case that tax is imposed in all three states, for example if the source state chooses not to impose tax on the income, if one or both of the residence states operates a territorial system, or if the income is covered by a domestic exemption in one or both of the residence states. In addition, if the residence states do impose tax then they may grant unilateral double taxation relief, either by granting a credit for the foreign tax imposed or by exempting the income. Nevertheless, for the purposes of the analysis below, it will be assumed that all three states do seek to impose tax on the income under their domestic laws and that neither of the residence states grants any unilateral relief.

It should be noted that the actual flows of income (e.g., the location of bank accounts) are not relevant for the analysis set out below. It is the derivation of income by a dual resident company, along with the fact that the source state considers the income to be locally sourced under its domestic laws, which gives rise to the multiple taxing claims in dual-resident triangular cases.

The analysis in this section deals only with certain categories of income identified in the OECD Model, namely business profits (Article 7), dividends (Article 10), interest (Article 11), royalties (Article 12), income from immovable property (Article 6), income from shipping, inland waterways transport and air transport (Article 8), capital gains (Article 13) and other income (Article 21). It does not discuss income from employment (Article 15), directors’ fees (Article 16), artistes and sportsmen (Article 17), pensions (Article 18), government service (Article 19) or students (Article 20), which are outside the scope of this study.

10.4.1. Situations where tie-breaker does not effectively allocate residence

There are a number of situations, as discussed above, where the tie-breaker provision of the treaty between the two residence states may not be effective in allocating the residence of a dual-resident company to one state for the purposes of the treaty. This may occur, for example, where a company has its management split between two states such that it is not clear where the company’s place of effective management is located. It can also occur in the case of individuals who have strong ties to two states if those states cannot agree on the application of the tie-breaker provisions.

The following diagram illustrates a dual resident triangular situation where there is no effective allocation of residence for the purposes of the treaty between the two residence states. In this diagram the source state is marked “State S” and the two residence states are marked “State A” and “State B.”
The applicable treaties in this case will be:

(i) The treaty between the two residence states (the A-B treaty);
(ii) The treaty between the first residence state and the source state (the A-S treaty); and
(iii) The treaty between the second residence state and the source state (the B-S treaty).

The lack of an effective allocation of residence will have implications for the application of the treaty between the two residence states. For the purposes of the treaties which each of those two states have concluded with the source state, however, the person will simply remain resident in both residence states and will thus be able to claim the benefit of both treaties. This can be contrasted with situations where the tie-breaker rule is effective in allocating residence for the purposes of the treaty between the two residence states, in which case the application of the treaty between the losing residence state and the source state is less certain (as will be seen in Sections 10.4.2. and 10.4.3. below and in Chapter 11).

10.4.1.1. Application of the treaty between the two residence states

If the tie-breaker rule of the treaty between the two residence states does not effectively allocate residence to one state, then it is not clear how the treaty between the two residence states should be applied. One possibility is that the person involved would be able to claim treaty benefits in both states as though they were a resident of the other contracting state. To give an example, Article 7 of the treaty between the two residence states would usually allow business profits to be taxed only in the residence state unless they are attributable to a PE in the other state. If a dual resident derives business profits which are not attributable to a PE in either residence state, and both states apply the treaty as though the person deriving the income is a resident of the other state, then both states may be prevented from imposing tax under Article 7. This would clearly be an undesirable outcome from the perspective of the contracting states and it relies on both contracting states accepting that the person involved is resident in the other contracting state (and is not a local resident) for treaty purposes.

The more likely scenario is that both states would take the view that the tie-breaker provision should resolve the residence of the dual resident in their favour, e.g., in the case of a dual-resident company, both states may consider that the place of effective management of the company is located within their territory. In this case, both residence states are likely to apply the treaty as though the person involved is a local resident for treaty purposes and is not a resident of the other contracting state. As a result, it is likely that neither state would accept any restriction on its taxing rights under the treaty (except to the extent that the treaty imposes restrictions on the residence state), and both states may impose tax on the income.

1178 This does not commonly occur, however there are certain circumstances in which a residence state may be prevented from imposing tax. This could occur, for example, in the case of certain students deriving income which is dealt with under Article 20. Article 20 provides that: “Payments which a student or business apprentice who is or was immediately before visiting a Contracting State a resident of the other Contracting State and who is present in the first-mentioned State solely for the purpose of his education or training receives for the purpose of his maintenance, education or training shall not be taxed in that State, provided that such payments arise from sources outside that State.” Thus, in certain circumstances, Article 20 may prevent a residence state from imposing tax.
The question then arises as to the extent to which one or both of the residence states will grant relief for the tax imposed in the other residence state. Whether a particular state grants relief would generally depend upon whether it considers the tax imposed in the other contracting state to be imposed in accordance with the terms of the treaty. Relief may be granted, if, for example, the state deciding whether to grant relief views the income as being attributable to a PE in the other state for the purposes of the treaty. Where one of the residence states grants relief for tax imposed in the other residence state, unrelieved double taxation would generally be prevented (provided that, if it is a triangular case, both residence states grant relief for tax imposed in the source state). However, if neither residence state grants relief for tax imposed in the other residence state then unrelieved double taxation will persist. Issues may also arise where both residence states grant relief using the credit method for the tax imposed in the other residence state. In this case, the calculation of the amount of the credit would become circular, since the credit available in each state would depend upon the tax imposed (and thus on the credit available) in the other state. It is clearly very important, both in bilateral and multilateral situations, that the tie-breaker provision of the treaty between the two residence states allocates the residence of a dual resident to one state for the purposes of that treaty.

10.4.1.2. Application of the treaties between the residence states and the source state

In situations where there is no effective allocation of residence under the treaty between the two residence states then it is quite clear that the source state will be bound by the conditions of two treaties. The dual resident deriving the income is a resident of each of the two residence states under their respective domestic laws and thus, will be considered resident under Article 4(1) of their respective treaties with the source state. The source state will therefore be bound to apply the conditions of both these treaties and will only be able to meet its treaty obligations by applying the terms of the treaty which are most favourable to the dual resident deriving the income. In practice, the application of multiple treaty conditions will only have an impact where the conditions of the two treaties differ, such that the source state would be permitted to impose tax under one of the applicable treaties but is prevented from imposing tax under the other applicable treaty or with respect to passive income where the applicable rates differ.

Where the source state is permitted to impose tax, both residence states will have an obligation to grant relief under their respective treaties with the source state, either by exempting the income or by granting a credit for the tax imposed in the source state. If one of the residence states exempts the income, or imposes no residual tax after the allowance of foreign tax credits (i.e., for the tax imposed in the source state), then there would generally be no unrelieved double taxation regardless of the application of the treaty between the two residence states. If, however, both residence states do impose tax after the provision of relief for tax imposed in the source state, then unrelieved double taxation can still occur despite relief provided for tax imposed in the source state, i.e., where both residence states impose tax and neither state provides relief for the tax imposed in the other residence state. Again, this highlights the

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1179 The relief provisions of the OECD Model (Article 23A and Article 23B) require the residence state to grant relief when tax is imposed in the other state "in accordance with the provisions" of the Convention. Article 23A(1), for example, provides that: "Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax." Similarly, Article 23B(1) provides that: "Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall allow….”

1180 Couzin, R., Corporate Residence…, at p. 166 (Section 3.2.1.). Tax would be imposed in the source state and in both residence states, with the residence states granting relief for tax imposed in the source state.

1181 For example, a dividend of $100 is paid (assuming no source state taxation) and the tax rate in both A and B is 30%. In the absence of any tax credit, $30 tax is due in each state (A and B). If each state then allows a credit for the tax imposed in the other state then no tax will be payable in either state ($30 tax less $30 credit), however if no tax is payable then no credit is available and thus $30 tax is still payable. This is clearly circular and it is not clear what the final outcome should be. This problem is not confined to cases where the tax rates are the same; a similar result occurs if the tax rates in A and B differ.

importance of an effective allocation of residence under the tie-breaker provision of the treaty between the two residence states.

10.4.2. Situations where the tie-breaker effectively allocates residence to one state

In most cases involving dual residents, it is likely that the application of the tie-breaker rules of the treaty between the two residence states will effectively allocate residence to one of those states. This greatly simplifies the application of the treaty between the two residence states, but, as mentioned above, it raises additional issues in relation to the application of treaties between the losing residence state and third states.

The following diagram illustrates a dual resident triangular situation where there is an effective allocation of residence for the purposes of the treaty between the two residence states. In this diagram the source state is marked “State S”, the winning residence state is marked “State W” and the losing residence state is marked “State L.”

Figure 10.3.: Dual resident triangular case where tie-breaker provision of the treaty between the two residence states assigns residence to one state

The applicable treaties in this case will be:

(i) The treaty between the two residence states (the W-L treaty);
(ii) The treaty between the winning residence state and the source state (the W-S treaty); and
(iii) Potentially, the treaty between the losing residence state and the source state (the L-S treaty).

The application of these treaties will be discussed in detail below.

10.4.2.1. Application of the treaty between the two residence states

Where there is an effective allocation of residence under the tie-breaker provision of the treaty between the two residence states, that treaty will be applied as though the income is derived by a resident of the winning residence state. The losing residence state’s ability to impose tax will therefore depend on the terms of the treaty and the extent to which it allows source-based taxation. In general, however, the treaty will prevent the losing residence state from imposing tax on income derived by the dual resident from sources in third states (provided there is no PE in the losing residence state). This is illustrated in the following table, which shows the outcome of the application of the treaty between the two residence states in a dual resident triangular case. This table is based on a situation where (i) there is an effective allocation of residence under the tie-breaker provision of the treaty between the two residence states and (ii) the income is not attributable to a PE in the losing residence state for the purposes of the treaty between the two residence states (situations where there is a PE in State L will be discussed in Section 10.4.3., below).
Table 1: Application of the W-L treaty where there is no PE in State L

<table>
<thead>
<tr>
<th>Category of income</th>
<th>Applicable treaty article</th>
<th>Can State L impose tax?</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business profits</td>
<td>Article 7</td>
<td>No</td>
<td>There is no PE in State L and State L is therefore prevented from imposing tax.</td>
</tr>
<tr>
<td>Dividends</td>
<td>Article 7 or Article 21</td>
<td>No</td>
<td>Article 10 does not apply because the dividends are not paid by a resident of State L. Instead, Article 7 or Article 21 applies, depending on whether the income is considered to be business profits, and State L is prevented from imposing tax (since the dividends are not attributable to a PE in State L).</td>
</tr>
<tr>
<td>Interest</td>
<td>Article 7 or Article 21</td>
<td>No</td>
<td>Article 11 does not apply because the interest does not arise in State L. Instead, Article 7 or Article 21 applies, depending on whether the income is considered to be business profits, and State L is prevented from imposing tax (since the interest is not attributable to a PE in State L).</td>
</tr>
<tr>
<td>Royalties</td>
<td>Article 7 or Article 21</td>
<td>No</td>
<td>Article 12 does not apply because the royalties arise in a third state. Instead, Article 7 or Article 21 applies, depending on whether the income is considered to be business profits, and State L is prevented from imposing tax (since the royalties are not attributable to a PE in State L).</td>
</tr>
</tbody>
</table>

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1183 Article 10 applies to: “Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State...” (Article 10(1)).
1184 Article 11 applies to: “Interest arising in a Contracting State and paid to a resident of the other Contracting State...” (Article 11(1)). Article 11(5) provides that: “Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated.” In this situation, the interest is not paid by a resident of State L and is not borne by a PE located in that state; the interest therefore does not arise in State L.
1185 Article 12 applies to “Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State...” (Article 12(1)). In this situation, where the royalties arise in a third state, Article 12 will therefore not apply.
| Income from immovable property (property located in the source state). | Article 7 or Article 21 | No | Article 6 does not apply because the immovable property is not located in State L. Instead, Article 7 or Article 21 applies, depending on whether the income is considered to be business profits, and State L is prevented from imposing tax on the income (since it is not attributable to a PE in State L).  
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Figure 10.8.: Dual resident triangular case involving income from immovable property</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| Income from shipping, inland waterways transport and air transport | Article 8 | No | Under Article 8, tax can only be imposed in the state where the place of effective management is located. Given that residence is assigned to State W under the tie-breaker provision, it can be assumed that the place of effective management is located in State W. State L will therefore be prevented from imposing any tax on the income.  
| **Figure 10.9.: Dual resident triangular case involving income dealt with under Article 8** | | |  
| Capital gains arising from the alienation immovable property (property located in the source state) | Article 13(5) | No | Article 13(1) does not apply because the immovable property is not located in State L. Instead, since none of the other paragraphs of Article 13 apply, Article 13(5) applies. Article 13(5) provides that any capital gains not referred to in other paragraphs of Article 13 can only be taxed in the residence state. For the purpose of applying the treaty between the two residence states, State W is the residence state and therefore, State L is prevented from imposing tax on the gain.  
| **Figure 10.10.: Dual resident triangular case involving capital gains dealt with under Article 13(1)** | | |  

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1186 For a detailed analysis of the applicable treaty article in relation to income from immovable property located in a third state, refer to Chapter 2 (Section 2.6.). The discussion in that section was framed in terms of PE triangular cases, but applies equally in dual resident triangular cases. It was concluded there that the income may fall under either Article 7 or Article 21 depending on whether it is considered to be business profits for the purposes of the treaty.
| Capital gains arising from the alienation of movable property which forms part of the business property of a PE (assuming the capital gain is attributable to a PE located in the source state) | Article 13(5) | No | For the purposes of the analysis here, it is assumed that there is no PE in State L. Article 13(2) can therefore not apply. If a dual resident derives a capital gain from the alienation of movable property forming part of the business property of a PE located in the source state, then Article 13(5) would apply for the purposes of the treaty between the two residence states. Under Article 13(5), State L would be prevented from imposing any tax on the gain. |
| Capital gains arising from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport or associated movable property | Article 13(5) | No | Under Article 13(3), tax can only be imposed in the state where the place of effective management is located. Given that residence is assigned to State W under the tie-breaker provision, it can be assumed that the place of effective management is located in State W. State L will therefore be prevented from imposing any tax on the capital gain. |
| Capital gains arising from the alienation of shares deriving more than 50% of their value from immovable property (property located in the source state) | Article 13(5) | No | Article 13(4) allows a state to impose tax on a capital gain arising from the alienation of shares if the shares derive more than 50% of their value from immovable property located in that state. Article 13(4) cannot apply because the property is not located in either of the contracting states. Instead, Article 13(5) applies and the losing residence state is prevented from imposing tax |
This table clearly illustrates that, in the absence of a PE in the losing residence state, the treaty between the two residence states will prevent the losing residence state from imposing tax on any income arising in third states. It is for this reason that the application of the treaty between the losing residence state and the source state gives rise to tax avoidance concerns.

To the extent that the losing residence state is prevented from imposing tax under the W-L treaty, dual resident triangular cases would generally not give rise to any unrelieved double taxation. Tax may be imposed in the source state and the winning residence state, but to the extent that tax may be imposed in the source state, the winning residence state would grant relief under the terms of the W-S treaty.

### 10.4.2.2. Application of the treaties between the residence states and the source state

Where there is an effective allocation of residence, it is quite clear that the dual resident will remain resident in the winning residence state for the purposes of the treaty between that state and the source state. What is less clear is the application of the treaty between the losing residence state and the source state; this will be discussed in detail in Chapter 11.

The result of the application of the W-S treaty in a dual resident triangular case is illustrated in the following table.
<table>
<thead>
<tr>
<th>Category of income</th>
<th>Relevant treaty article</th>
<th>Can State S impose tax?</th>
<th>Relief in State W?</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business profits</strong></td>
<td>Article 7</td>
<td>No</td>
<td>No</td>
<td>Assuming there is no PE in the source state, the source state will be prevented from imposing tax. If the income is attributable to a PE in the source state then the source state would be entitled to impose tax on the income and State W would be obliged to grant relief.</td>
</tr>
<tr>
<td><strong>Figure 10.16.: Dual resident triangular case involving business profits</strong></td>
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</tr>
<tr>
<td><strong>Dividends</strong></td>
<td>Article 10</td>
<td>Yes</td>
<td>Credit</td>
<td>It is assumed that the dividends are paid by a resident of State S. Article 10 therefore applies and State S may impose tax on the dividends. The amount of tax that can be imposed is limited to a certain percentage of the gross amount of the dividends. Regardless of the general method of relief in the treaty, State W will typically be required to grant relief using the credit method (Article 23A/B).</td>
</tr>
<tr>
<td><strong>Figure 10.17.: Dual resident triangular case involving dividends</strong></td>
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<tr>
<td><strong>Interest</strong></td>
<td>Article 11</td>
<td>Yes</td>
<td>Credit</td>
<td>The interest arises in State S and therefore, Article 11 applies. Under Article 11, the source state may impose tax on the interest, but the amount of tax that can be imposed is limited to a certain percentage of the gross amount of the interest. Regardless of the general method of relief in the treaty, State W will typically be required to grant relief using the credit method (Article 23A/B).</td>
</tr>
<tr>
<td><strong>Figure 10.18.: Dual resident triangular case involving interest</strong></td>
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</tr>
<tr>
<td><strong>Royalties</strong></td>
<td>Article 12</td>
<td>No / Yes</td>
<td>No / Credit</td>
<td>The royalties arise in State S and Article 12 therefore applies. Article 12 of the OECD Model does not allow any source-based taxation of royalties, however in practice, many treaties do allow a limited rate of source based taxation. Where this is the case, State W would generally be obliged to grant credit relief regardless of the general method of relief used in the treaty.</td>
</tr>
<tr>
<td><strong>Figure 10.19.: Dual resident triangular case involving royalties</strong></td>
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<tr>
<td><strong>Income from immovable property</strong> (property located in the source state)</td>
<td>Article 6</td>
<td>Yes</td>
<td>Credit or Exemption</td>
<td>The income is derived from immovable property located in State S and Article 6 will therefore apply. Under Article 6, State</td>
</tr>
<tr>
<td><strong>Figure 10.20.</strong>: Dual resident triangular case involving income from immovable property</td>
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<tr>
<td></td>
<td></td>
<td>S will be entitled to impose tax on income. State W will be obliged to provide relief using the method specified in the treaty.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Income from shipping, inland waterways transport and air transport</th>
<th>Article 8</th>
<th>No</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Figure 10.21.</strong>: Dual resident triangular case involving income dealt with under Article 8</td>
<td>Article 8 will apply. Under Article 8, tax can only be imposed in the state where the place of effective management is located. Given that residence of the dual resident receiving the income is assigned to State W under the tie-breaker provision, it can be assumed that the place of effective management is located in State W. State S will therefore be prevented from imposing any tax on the income and State W will have no obligation to provide relief.</td>
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</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital gains arising from the alienation of immovable property (property located in the source state)</th>
<th>Article 13(1)</th>
<th>Yes</th>
<th>Credit or Exemption</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Figure 10.22.</strong>: Dual resident triangular case involving capital gains dealt with under Article 13(1)</td>
<td>Article 13(1) will apply and State S may impose tax on the capital gain. State W will be obliged to provide relief using the method specified in the treaty.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital gains arising from the alienation of movable property which forms part of the business property of a PE</th>
<th>Article 13(2)</th>
<th>Yes</th>
<th>Credit or Exemption</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Figure 10.23.</strong>: Dual resident triangular case involving capital gains dealt with under Article 13(2)</td>
<td>Article 13(2) applies and the source state is entitled to impose tax on the capital gain. State W will be required to provide relief using the method specified in the treaty.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Description</td>
<td>Article 13(3)</td>
<td>Article 13(4)</td>
<td>Article 13(5)</td>
</tr>
<tr>
<td>---------------------------------------------------------------------------</td>
<td>---------------</td>
<td>---------------</td>
<td>---------------</td>
</tr>
<tr>
<td>Capital gains arising from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport and associated movable property</td>
<td>No</td>
<td>No</td>
<td>Article 13(3) applies. Under Article 13(3), tax can only be imposed in the state where the place of effective management is located. Given that residence is assigned to State W under the tie-breaker provision, it can be assumed that the place of effective management is located in State W. State S will therefore be prevented from imposing any tax on the capital gain.</td>
</tr>
<tr>
<td>Capital gains arising from the alienation of shares deriving more than 50% of their value from immovable property (property located in the source state)</td>
<td>Yes</td>
<td>Credit or Exemption</td>
<td>Article 13(4) applies and the source state will be entitled to impose tax on the capital gain. State W will be obliged to provide relief using the method specified in the treaty.</td>
</tr>
<tr>
<td>Other capital gains</td>
<td>No</td>
<td>No</td>
<td>Article 13(5) provides that any capital gains not referred to in other paragraphs of Article 13 can only be taxed in the residence state. Under Article 13(5), State S will be prevented from imposing any tax on the gain.</td>
</tr>
</tbody>
</table>
### Other income

*Figure 10.27.: Dual resident triangular case involving other income*

<table>
<thead>
<tr>
<th>Article 21</th>
<th>No</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assuming there is no PE in the source state, the source state will be prevented from imposing tax under Article 21. State W will therefore have no obligation to provide relief.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The application of the W-S treaty therefore allows the source state to impose tax on a number of types of income arising in that state, including passive income (dividends, interest and possibly royalties), income from immovable property, and certain types of capital gains. If the income were attributable to a PE of the dual-resident located in the source state then the source state would also be able to impose tax on certain other types of income, particularly business profits (under Article 7) and other income (under Article 21), and would not be subject to a maximum tax rate for passive income. Where the source state is entitled to impose tax, State W will have a corresponding obligation to provide relief.

**Impact of the L-S treaty applying in addition to the W-S treaty**

If the L-S treaty applies in addition to the W-S treaty, then the source state will be obliged to apply the conditions of both treaties. As a result, the source state will only be able to meet its treaty obligations by applying the treaty conditions which are most favourable to the person deriving the income. The practical impact of applying the conditions of both treaties is likely to depend on the category of income involved. In relation to dividends, interest and royalties, for example, it is common for the maximum rate of source based taxation to vary between treaties and where this occurs, the source state would be obliged to apply the lower of the two rates. For other categories of income, such as income from immovable property and income from shipping and air transport, variations are less common and therefore, the application of both treaties may give the same result. Differences in the PE definition may also be very important in some cases, i.e., where the dual-resident would have a PE in the source state under the definition contained in the W-S treaty but does not have a PE under the definition contained in the L-S treaty. In such cases the source state would clearly be concerned about the potential for improper use of the L-S treaty; this is discussed further in the following section.

Regardless of the application of the L-S treaty, the losing residences state will generally not provide any relief for tax imposed in the source state (either exemption or credit) since it imposes no tax on the income. This assumes, of course, that the limitation of State L’s taxing rights under the treaty between the two residence states is taken into account for the purposes of applying the L-S treaty. If the treaty limitation is not taken into account, and State L imposes tax on the income under its domestic law, then State L may theoretically have a relief obligation under the L-S treaty (if it applies) despite not being able to impose any tax on the income. This would clearly be an inappropriate outcome. This issue was discussed in detail in Chapter 3 (in the context of PE triangular cases), where it was concluded that the

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treaty limitation should be taken into account\textsuperscript{1188} and thus, that a state which is prevented from imposing tax under one treaty should not have any relief obligation under another applicable treaty. This applies equally with respect to the losing residence state in a dual resident triangular case.

10.4.2.3. Potential for improper use of treaties

The primary concern of most states in relation to dual-resident triangular cases is the potential for tax avoidance through the improper use of treaties, particularly in order to gain reductions in source based taxation. A company could, for example, be incorporated in one state and effectively managed from another, making it a dual resident, in order to take advantage of the treaties between those two residence states and a third state (the source state). As mentioned above, the source state could only satisfy its treaty obligations in such cases by applying the treaty conditions that are most favourable to the taxpayer.\textsuperscript{1189} Of particular concern for source states is the possibility that a dual-resident company could claim a reduction in source based taxation under the L-S treaty in situations where the treaty between the two residence states prevents State L from imposing any tax on the income. This is especially concerning in light of the ease with which a company can become resident under domestic laws (e.g., by incorporation or by holding board meetings in a particular state)\textsuperscript{1190} and thus, under tax treaties.

The source state may therefore wish to deny the benefit of the L-S treaty, particularly in relation to income which the losing residence state is prevented from taxing under the treaty between the two residence states. This may not be easy to accomplish, however, since residence for treaty purposes depends on domestic laws and must be determined independently for each treaty. It is sometimes possible to attack a claim for treaty benefits in relation to dividends, interest or royalties on the basis that the recipient is not the beneficial owner of the income, however there is no particular reason why a dual resident is less likely to be the beneficial owner of its income than any other person.\textsuperscript{1191} It may also be possible for the source state to rely on anti-avoidance provisions included in its domestic law, but this is likely to raise questions regarding whether the source state has satisfied its obligations under international law.\textsuperscript{1192}

The OECD Commentary takes the position that a company whose residence has been allocated to one state under a tax treaty will not be a resident of the losing residence state for the purposes of treaties between that state and third states on the basis of the second sentence of Article 4(1),\textsuperscript{1193} which reads as follows:

"This term [resident of a Contracting State], however, does not include any person who is liable to tax in that State in respect only of sources in that State or capital situated therein."

The view expressed in the OECD Commentary is that, as a result of the restrictions imposed on State L under the treaty between the two residence states, the dual resident is taxable in State L only on income from sources in that state and will therefore not be resident in State L for the purposes of the L-S treaty. On the basis of this interpretation, the source state could potentially deny treaty benefits to dual resident

\textsuperscript{1188} Refer to Section 3.3. Broadly, it was concluded in that section that for the purposes of determining the amount of tax which the residence state imposes on the income, and thus for determining the amount of credit relief which should be granted, consideration should be given to the actual amount of tax imposed (taking into account any treaty limitations) and should not be limited to the amount of tax imposed under domestic law of the residence state. While tax treaties are bilateral and do not have effect for the purposes of other tax treaties, the impact which tax treaties have on the operation of domestic law cannot be ignored for the purposes of applying other tax treaties. In addition, it cannot be said that, by taking into account the exemption of the income under the treaty with the PE state and refusing to grant credit relief, the residence state is failing to interpret the terms of the treaty in good faith.


\textsuperscript{1190} For a brief overview of domestic residence rules, see Section 10.2.

\textsuperscript{1191} For a discussion of the beneficial ownership concept, please refer to Chapter 5 (Section 5.2.6.1).

\textsuperscript{1192} For discussion of this topic, see, inter alia: Arnold, B.J., & Van Weeghel, S., "The Relationship Between..."; and De Broe, L., \textit{International Tax Planning...} (see pp. 377-460, Part 3, Chapter 4).

\textsuperscript{1193} 2010 OECD Commentary on Article 4, para 8.2.
persons under the treaty which it has concluded with the losing residence state. This approach is controversial, however, and will be discussed in detail in Chapter 11.

10.4.3. Situations where there is a PE in the losing residence state

This section deals with dual resident triangular situations where the tie-breaker provision of the treaty between the two residence states effectively allocates the person’s residence to one state (i.e., State W), but where the income arising in a third state is attributable to a PE in the losing residence state (i.e., State L) for the purposes of the treaty between the two residence states. Whether a PE exists in the losing residence state will depend on the activities carried out there.\(^{1194}\) The fact of incorporation alone would not be enough to give rise to a PE in State L,\(^{1195}\) however, where there are also business activities conducted in that state those activities could very well amount to a PE. If so, the situation is very similar to a PE triangular case and many of the issues arising in PE triangular cases become relevant. The main difference between a PE triangular case and a dual resident triangular case with a PE in State L is that, in the dual-resident triangular case, the company may to be entitled to the benefit of treaties between State L (now also the PE state) and third states. This situation is illustrated in the following diagram (in this diagram the source state labelled “State S”, the winning residence state is labelled “State W” and the losing residence state is labelled “State L”).

Figure 10.28.: Dual resident triangular situation where there is a PE in the losing residence state

The applicable treaties in this case will be:

(i) The treaty between the two residence states (the W-L treaty);

(ii) The treaty between the winning residence state and the source state (the W-S treaty); and

(iii) Potentially, the treaty between the losing residence state and the source state (the L-S treaty).

The application of these treaties will be discussed in detail below.

10.4.3.1. Application of the treaty between the two residence states

The following table illustrates the result of the application of the treaty between the two residence states in situations where the income arising in the source state is attributable to a PE in the losing residence state. For categories of income where the result differs due to the existence of the PE, the third column is shaded.

Table 3: Income attributable to a PE in the losing residence state

<table>
<thead>
<tr>
<th>Category of income</th>
<th>Relevant treaty article</th>
<th>Can State L impose tax?</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business profits</td>
<td>Article 7</td>
<td>Yes</td>
<td>Article 7 applies and State L is entitled to impose tax on the profit attributable to the PE.</td>
</tr>
</tbody>
</table>

\(^{1194}\) Whether a PE exists must be determined in accordance with the PE definition contained in the treaty (Article 5).

\(^{1195}\) Article 5, OECD Model.
<table>
<thead>
<tr>
<th><strong>Figure 10.29:</strong> Dual resident triangular case involving business profits</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Dividends**  
*Figure 10.30.: Dual resident triangular case involving dividends*  
**Article 7**  
**Yes**  
Article 10 does not apply because the dividends are not paid by a resident of State L. Instead, Article 7 applies, either because the dividends are considered to be business profits or as a result of Article 21(2). Under Article 7, State L may impose tax on the profit attributable to the PE.

<table>
<thead>
<tr>
<th><strong>Figure 10.31.: Dual resident triangular case involving interest</strong></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Interest**  
*Figure 10.31.: Dual resident triangular case involving interest*  
**Article 7**  
**Yes**  
Article 11 does not apply because the interest does not arise in State L. Instead, Article 7 applies, either because the interest is considered to be business profits or as a result of Article 21(2). Under Article 7, State L may impose tax on the profit attributable to the PE.

<table>
<thead>
<tr>
<th><strong>Figure 10.32.: Dual resident triangular case involving royalties</strong></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Royalties**  
*Figure 10.32.: Dual resident triangular case involving royalties*  
**Article 7**  
**Yes**  
Article 12 does not apply because the royalties do not arise in State L. Instead, Article 7 applies, either because the royalties are considered to be business profits or as a result of Article 21(2). Under Article 7, State L may impose tax on the profit.

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1196 Article 10 applies to: “Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State…” (Article 10(1)).

1197 Article 21 applies to income not dealt with under the other articles of the treaty, and provides that tax may only be imposed in the residence state (Article 21(1)). Article 12(2) provides that: “The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein and the right or property in respect of which the income is paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.”

1198 Article 11 applies to: “Interest arising in a Contracting State and paid to a resident of the other Contracting State…” (Article 11(1)). Article 11(5) provides that: “Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated.” In this situation, the interest is not paid by a resident of State L and is not borne by a PE located in that state; the interest therefore does not arise in State L.

1199 See above, note 92.

1200 Article 12 applies to “Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State…” (Article 12(1)). In this situation, where the royalties arise in a third state, Article 12 will therefore not apply.

1201 See above, note 92.
<table>
<thead>
<tr>
<th><strong>Income from immovable property</strong> (property located in the source state)</th>
<th>Article 7</th>
<th>Yes</th>
<th>Article 6 does not apply because the immovable property is not located in State L. Instead, Article 7 applies, either because the income is considered to be business profits or indirectly under Article 21(2).(^2) Under Article 7 State L may impose tax on the profit attributable to the PE.</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="image1" alt="Diagram" /></td>
<td><img src="image2" alt="Diagram" /></td>
<td><strong>Figure 10.33.: Dual resident triangular case involving income from immovable property</strong></td>
<td></td>
</tr>
</tbody>
</table>

\(^2\) See above, note 92. Although Article 21(2) excludes income from immovable property (such that Article 21 would continue to apply), it refers to the definition of immovable property in Article 6, which does not apply where the immovable property is located in a third state. See Chapter 2 for further discussion (Section 2.6.).
<table>
<thead>
<tr>
<th>Capital gains arising from the alienation of movable property which forms part of the business property of a PE (Property attributable to the PE in State L)</th>
<th>Article 13(2)</th>
<th>Yes</th>
<th>Where the dual resident derives a capital gain from the alienation of movable property which forms part of the business property of a PE located in State L, Article 13(2) will apply. State L may impose tax on the gain.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital gains arising from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport or associated movable property</td>
<td>Article 13(3)</td>
<td>No</td>
<td>Article 13(3) applies. Under Article 13(3), tax can only be imposed in the state where the place of effective management is located. Given that residence is assigned to State W under the tie-breaker provision of the W-L treaty, it can be assumed that the place of effective management is located in State W. State L will therefore be prevented from imposing any tax on the capital gain. The existence of a PE in State L has no impact on this result.</td>
</tr>
<tr>
<td>Capital gains arising from the alienation of shares deriving more than 50% of their value from immovable property (property located in the source state)</td>
<td>Article 13(2)</td>
<td>Yes</td>
<td>Article 13(4) allows a state to impose tax on a capital gain arising from the alienation of shares if the shares derive more than 50% of their value from immovable property located in that state. Article 13(4) does not apply, however, because the property is not located in either of the contracting states. On the basis that the shares are movable property forming part of the business property of the PE in State L, Article 13(2) applies. Under Article 13(2), State L may impose tax on the gain.</td>
</tr>
<tr>
<td>Other capital gains</td>
<td>Article 13(5)</td>
<td>No</td>
<td>Article 13(5) applies and State L will be prevented from imposing any tax on the gain.</td>
</tr>
<tr>
<td>---------------------</td>
<td>--------------</td>
<td>----</td>
<td>------------------------------------------------------------------</td>
</tr>
<tr>
<td>Other income</td>
<td>Article 7</td>
<td>Yes</td>
<td>As a result of Article 21(2), Article 7 applies. Under Article 7, State L may impose tax on the profit attributable to the PE.</td>
</tr>
</tbody>
</table>

This table illustrates that the existence of a PE in the losing residence state entitles that state to impose tax on a much wider range of income under the treaty between the two residence states than is the case in the absence of a PE. This would tend to reduce the level of concern about the improper application of the L-S treaty, since these concerns are in large part prompted by the non-taxation of the income in State L. Tax avoidance concerns may still exist, however, as a result of the source state being subject to the terms of multiple treaties in respect of the same income. The application of the treaties between the residence states and the source state is discussed in detail in the following chapter (Chapter 11). It should also be remembered that the existence of a PE in the losing residence state will only entitle that state to impose tax on income arising in a third state if the income is attributable to the PE for the purposes of the treaty between the two residence states.

10.4.3.2. Application of the treaties between the residence states and the source state

The existence of a PE in the losing residence state would generally have no impact on the application of the treaties between the two residence states and the source state. It remains quite clear that the dual resident will be resident in the winning residence state for the purposes of the W-S treaty, while also remaining unclear whether the dual resident will be able to claim the benefit of the L-S treaty; this will be discussed in detail in Chapter 11.

The application of the W-S treaty in a dual resident triangular case is illustrated in the following table. This table is largely the same as Table 2, since the existence of a PE in State L will generally have no impact on the application of the W-S treaty. However, this table also contains a column which indicates whether relief is required in the losing residence state, i.e., for those categories of income where the losing residence state is entitled to impose tax under the terms of the treaty between the two residences states (see Table 3). For additional comments regarding the application of the W-S treaty, refer to Table 2, above; the comments included in that table are not repeated here.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Business profits</td>
<td>Article 7</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>State L may impose tax under Article 7 of the W-L treaty, but State S is prevented from imposing tax under the W-S treaty.</td>
</tr>
</tbody>
</table>
| Dividends          | Article 10                         | Yes                    | Credit                                      | Credit                                          | State L may impose tax under Article 7 of the W-L treaty and tax may also be imposed in State S.  
In relation to dividends, the credit method typically applies regardless of the general method of relief used in the treaty. |
| Interest           | Article 11                         | Yes                    | Credit                                      | Credit                                          | State L may impose tax under Article 7 of the W-L treaty and tax may also be imposed in State S.  
In relation to interest, the credit method typically applies regardless of the general method of relief used in the treaty. |
| Royalties          | Article 12                         | No / Yes               | No / Credit                                 | No / Credit                                     | Article 12 of the OECD Model does not allow source based taxation of royalties, however in practice many treaties vary from the OECD Model and allow a limited rate of source based taxation.  
State L may impose tax under Article 7 of the W-L treaty and tax may also be imposed in State S.  
In relation to royalties, the |
<table>
<thead>
<tr>
<th>Income from immovable property (property located in the source state)</th>
<th>Article 6</th>
<th>Yes</th>
<th>Credit or Exemption</th>
<th>Credit or Exemption</th>
<th>State L may impose tax under Article 7 of the W-L treaty (see Table 3) and tax may also be imposed in State L.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Article 8</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Income from shipping and air transport may only be taxed in the state where the place of effective management is located.</td>
<td></td>
</tr>
<tr>
<td>Capital gains arising from the alienation immovable property (property located in the source state)</td>
<td>Article 13(1)</td>
<td>Yes</td>
<td>Credit or Exemption</td>
<td>No</td>
<td>State L is prevented from imposing tax under the W-L treaty (see Table 3).</td>
</tr>
<tr>
<td>Capital gains arising from the alienation of movable property which forms part of the business property of a PE</td>
<td>Property attributable to PE in State L: Article 13(5)</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No relief is required in State L because State S is prevented from imposing tax under the W-S treaty.</td>
</tr>
<tr>
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<td>---</td>
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<td>---</td>
</tr>
<tr>
<td>Capital gains arising from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport and associated movable property</td>
<td>Figure 10.49.: Dual resident triangular case involving capital gains dealt with under Article 13(3)</td>
<td>Article 13(3)</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Capital gains arising from the alienation of shares deriving more than 50% of their value from immovable property (property located in the source state)</td>
<td>Figure 10.50.: Dual resident triangular case involving capital gains dealt with under Article 13(4)</td>
<td>Article 13(4)</td>
<td>Yes</td>
<td>Credit or Exemption</td>
<td>No</td>
</tr>
<tr>
<td>Other capital gains</td>
<td>Article 13(5)</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No relief is required in State L because both State L and State S are prevented from imposing tax.</td>
</tr>
<tr>
<td>---------------------</td>
<td>---------------</td>
<td>----</td>
<td>----</td>
<td>----</td>
<td>----------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Other income</td>
<td>Article 21</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No relief is required in State L because State S is prevented from imposing tax under the W-S treaty.</td>
</tr>
</tbody>
</table>

This table illustrates that, in situations where there is an effective allocation of residence and the income is attributable to a PE in the losing residence state, there are only a few categories of income where tax may be imposed in all three states. These are, namely, dividends, interest, royalties (provided the applicable treaties differ from the OECD Model and allow source-based taxation) and income from immovable property. In relation to other categories of income, either the source state or the losing residence state (or both) will be prevented from imposing tax under their respective treaties with the winning residence state.

10.4.3.3. Potential double taxation where there is a PE in the losing residence state

Where the losing residence state is entitled to impose tax on income arising in third states as a result of that income being attributable to a PE, the situation is effectively the same as a PE triangular case. As in PE triangular cases, the winning residence state may not be able to provide sufficient relief to prevent double taxation unless the losing residence state also provides relief for tax imposed in the source state. If the L-S treaty applies, it will require the losing residence state to grant relief for tax imposed in the source state and unrelieved double taxation will be prevented. However, if the L-S treaty does not apply (e.g., in accordance with the view expressed in the OECD Commentary on Article 4) then the losing residence state would generally have no explicit obligation to provide relief for tax imposed in the source state.

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1203 Refer to the analysis in Chapter 3 regarding the residence state's ability to grant sufficient relief in PE triangular cases (see Section 3.2.).

1204 Except perhaps, under the PE non-discrimination article (Article 24(3)) of the treaty between the two residence states (i.e., as in PE triangular cases: refer to the analysis in Chapter 4, where it was argued that a relief obligation
and thus, unrelieved double taxation may arise. The losing residence state may have a relief obligation under the non-discrimination article (Article 24(3)) of the W-L treaty, but the lack of a direct relief obligation nevertheless suggests that it would be preferable for the L-S to continue to apply, at least in situations where the income is attributable to a PE in the losing residence state.

The best way to resolve the conflict between the desire to deny treaty benefits to dual residents to prevent treaty shopping and the desire to prevent unrelieved double taxation would be to broadly prevent dual residents from being resident in State L for the purposes of treaties between that state and third states, but to extend treaty benefits to PEs (as proposed, in particular, in Chapters 7, 8 and 9). As a result, dual residents would generally only be entitled to claim the benefits of one treaty in the source state; the applicable treaty would usually be the W-S treaty but, in situations where the income is attributable to a PE in State L, the applicable treaty would be the L-S treaty (i.e., the treaty between the PE state and the source state). Thus, improper access to the L-S treaty could be prevented while still ensuring that unrelieved double taxation would not arise. This will be discussed further in Chapter 11.

Potential dual relief obligation in the winning residence state

Where State L is entitled to impose tax on income arising in third states under the W-L treaty, State W will generally have an obligation to provide relief under both the W-S treaty and the W-L treaty. As a result, State W may potentially have an obligation to grant dual relief (e.g., an exemption and a credit) in relation to the same income. This potential dual relief obligation also arises in PE triangular cases, and was discussed in detail in Chapter 3, where it was concluded that if certain income is exempt under one applicable treaty, then that exemption should be taken into account for the purposes of determining the amount of credit relief required under another applicable treaty. As a result, the residence state should not have any dual relief obligation despite being subject to the relief provisions of two treaties in relation to the same item of income. That analysis applies equally here.

10.4.4. Impact of retroactive determination of residence under tie-breaker rules

The residence of a dual resident company for the purposes of the treaty between its two residence states may be determined under the mutual agreement procedure, either because the application of the tie-breaker in Article 4(3) is not clear and the company initiates the mutual agreement procedure under Article 25, or because the tie-breaker itself provides for residence to be determined by mutual agreement. Where this occurs, the residence of the company may not be determined until a relatively long period of time has elapsed. In such cases, the allocation of residence would generally be implemented retroactively in the two residence states. That is, the company would be treated as a resident of the relevant state for the purposes of the treaty at least back to the time in respect of which it initiated the mutual agreement procedure, but potentially even for earlier periods. As a result of Article 25(2), the contracting states will

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1205 Refer to Chapter 4 (Section 4.3.) for an in-depth discussion of the PE state’s potential relief obligation under Article 24(3) in PE triangular cases; that analysis applies equally here.
1206 Where the L-S treaty applies on the basis that the income is attributable to the PE, the W-S treaty should be excluded in relation to that income in the same way that the R-S treaty should be excluded in PE triangular cases. For this purpose, the provisions suggested in Chapter 7 to exclude the operation of the R-S treaty would apply equally in dual resident situations where there is a PE in the losing residence state (see Section 7.5.).
1207 Refer to Section 3.3. Broadly, it was concluded in that section that for the purposes of determining the amount of tax which the residence state imposes on the income, and thus for determining the amount of credit relief which should be granted, consideration should be given to the actual amount of tax imposed (taking into account any treaty limitations) and should not be limited to the amount of tax imposed under domestic law of the residence state. While tax treaties are bilateral and do not have effect for the purposes of other tax treaties, the impact which tax treaties have on the operation of domestic law cannot be ignored for the purposes of applying other tax treaties. In addition, it cannot be said that, by taking into account the exemption of the income under the treaty with the PE state and refusing to grant credit relief, the residence state is failing to interpret the terms of the treaty in good faith.
generally be able to implement the agreement, and apply the treaty as it should have been applied, despite any applicable time limits in domestic law.\footnote{Article 25(2) provides (in part) that: "Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States." This clearly applies where the taxpayer initiates the mutual agreement procedure under Article 25, and perhaps less clearly and more indirectly, should also apply where Article 4 provides for the residence of dual-resident persons to be determined by mutual agreement.}

The situation is not so clear, however, with respect to treaties concluded between the losing residence state and third states. In particular, the question arises as to whether the retroactive determination of residence under the treaty between the two residence states should also be taken into account retroactively for the purposes of treaties with third states.\footnote{Van den Berg, J-P., & Van der Gulik, B., "The Mutual Agreement..."} Assume, for example, that the treaty between the two residence states contains a provision along the lines of the mutual agreement tie-breaker contained in the OECD Commentary, which is worded as follows:

"Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting State.\footnote{2010 OECD Commentary on Article 4, para 24.1.}

Under this provision, the dual resident will not be treated as resident in either contracting state (i.e., for the purposes of the treaty between the two residence states) prior to a mutual agreement being reached. This means that neither state will be restricted by the treaty and consequently, the dual-resident will be taxable in both residence states under their domestic laws. In this situation, there would be nothing to prevent both treaties concluded by the residence states with the source state from applying. This is the case even if the second sentence of Article 4(1) prevents dual residents from being resident in the losing residence state for the purposes of treaties with third states, if there is a specific provision included in the treaties between the residence states and the source states, or if the result of a treaty tie-breaker is incorporated into the domestic law of the residence states. There has been no determination of residence under the treaty between the two residence states, and thus there can be no denial of residence in either state for the purposes of treaties with third states. As was mentioned above, this means that a dual resident company could ensure its continued eligibility under the treaties concluded by both its residence states with the source state by not initiating the mutual agreement procedure.\footnote{Van den Berg, J-P., & Van der Gulik, B., "The Mutual Agreement..."} This is clearly a weakness of the mutual agreement tie-breaker, particularly since there seems to be no authority for the contracting states to conclude an agreement in the absence of a request from the taxpayer.\footnote{Van den Berg, J-P., & Van der Gulik, B., "The Mutual Agreement..."}

Once an agreement has been reached with regard to residence for the purposes of the treaty between the two residence states (with retroactive effect), the question arises as to whether this allocation of residence will also have retroactive effect for the purposes of treaties with third states. Van der Berg and Van der Gulik write:

"We see no basis in the OECD model convention or the commentary for the position that a retroactive determination of residence by mutual agreement between two contracting states should retroactively affect the tax treaty status of the dual resident for the purposes of other treaties."\footnote{Van den Berg, J-P., & Van der Gulik, B., "The Mutual Agreement..."}

During the period prior to the mutual agreement being reached, the dual resident was taxable on its worldwide income in what is now the losing residence state (without any treaty restriction) and, at that time, would have satisfied the conditions of Article 4 of the treaty between that state and the source...
It is therefore difficult to see how the retroactive allocation of residence could have an impact on the application of the L-S treaty.

Even if the retroactive residence determination is effective for the purposes of the L-S treaty, with the result that the L-S treaty doesn't apply for the period for which residence has been determined, difficulties may arise in implementing the results of the non-application of that treaty in the source state. Prior to the allocation of residence for the purposes of the treaty between the two residence states, the source state was required to apply the conditions of two treaties and could only meet its treaty obligations by applying the conditions that were most favourable to the taxpayer. Generally therefore, the non-application of the L-S treaty will only have an impact where the conditions of that treaty are more favourable than the conditions of the W-S treaty and therefore, the source state will generally be seeking to impose more tax as a result of the non-application of that treaty. However, the source state may be prevented from revising the amount of tax imposed (e.g., by issuing and amended assessment and requesting additional payment) as a result of the time limits contained in its domestic law. There is no clear solution for addressing this issue. A specific provision could potentially be included in tax treaties, e.g., as part of a specific provision exclude treaty benefits where residence is assigned to a third state under an applicable treaty. However, determining the wording of such a provision would involve considerable difficulties, since the provision would need to apply to set aside the domestic time limits in circumstances where tax is being imposed because the treaty as a whole does not apply.

10.5. Conclusions

There are a number of factors which will influence the outcome of a dual resident triangular situation. One of the main factors is the application of the residence tie-breaker rule under the treaty between the two residence states. Where residence is not effectively assigned to one state there is a high likelihood of unrelieved double taxation (i.e., of tax being imposed in both residence states with no relief being provided) regardless of the category of income involved, and regardless of whether tax is also imposed in the source state. This highlights the importance of an effective allocation of residence.

Where residence is effectively assigned to one state for the purposes of the W-L treaty, the two most important factors influencing the outcome of triangular dual resident cases are whether the income is attributable to a PE in State L and whether the L-S treaty applies. In the absence of a PE, State L will generally be prevented from imposing tax on any income arising from third states, however if such income is attributable to a PE in State L, then depending on the category of income involved, State L may be entitled to impose tax. If the L-S treaty does not apply and there is a PE in State L, then unrelieved double taxation may occur. If the L-S treaty does apply, however, then there is a significant risk of improper claims for treaty benefits, since the source state will be bound by the conditions of its treaties with both residence states. This is of particular concern in situations where the losing residence state is prevented from imposing tax on the income under the treaty between the two residence states. The application of the L-S treaty is the key issue in dual-resident triangular cases and will be discussed in detail in the following chapter.

1214 Van den Berg, J-P., & Van der Gulik, B., ”The Mutual Agreement….”