Triangular cases: The application of bilateral tax treaties in multilateral situations
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Chapter 11
Residence under tax treaties with third states

11.1. Introduction

The primary issue in dual-resident triangular cases is the dual-resident's eligibility for treaty benefits under the treaty between their losing residence state and the source state. As a consequence of the fact that residence for treaty purposes depends on residence under domestic laws, and due to the bilateral nature of income tax treaties, residence must be determined independently for each treaty. Residence for treaty purposes is determined under Article 4(1) (or its equivalent), which provides that:

"For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of sources in that State or capital situated therein."\(^{1215}\)

Thus, whether a person\(^{1216}\) is resident in a particular state for treaty purposes depends upon whether they are resident in that state under its domestic laws. As a result, an allocation of residence under the tie-breaker provision of one particular treaty will have effect only for the purposes of that treaty and will generally have no impact on the application of other tax treaties.\(^{1217}\) As mentioned above, residence must always be determined independently for each individual treaty that is applied. 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 treaties which each of them have concluded with third states.\(^{1218}\) In a triangular situation, this means that a dual resident may be entitled to claim treaty benefits (including reductions in source based taxation) under the tax treaties concluded by both its residence states with the source state. If both these treaties apply then the source state will only be able to satisfy its treaty obligations by applying the treaty conditions that are more favourable to the person deriving the income.\(^{1219}\) As outlined in Chapter 10, this can give rise to significant tax avoidance concerns because the source state may continue to be bound by the conditions of its treaty with the state to which residence is not assigned (i.e., the losing residence state) in situations where that state is prevented from imposing tax under the treaty between the two residence states. As a result, source states may seek to deny treaty benefits to dual-residents under the L-S treaty.

The only argument for not applying the L-S treaty,\(^{1220}\) and the argument that is presented in the OECD Commentary,\(^{1221}\) is that the dual-resident is not resident in the losing residence state as a result of the second sentence of Article 4(1). The second sentence of Article 4(1) provides that a person will not be resident in a particular state if they are "liable to tax in that State in respect only of sources in that State". It is argued that a dual resident does not meet this condition for the purposes of the L-S treaty due to the restrictions imposed on the losing residence state's taxing rights under the treaty between the two

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\(^{1215}\) OECD Model 2010, Article 4(1).
\(^{1216}\) 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.
\(^{1217}\) Avery Jones, J.F., & Bobbett, C., "Triangular Treaty Problems..."; Avery Jones, J.F., "The Interaction Between..." at p. 137 (Chapter 6, Section 6.4.1.);
\(^{1218}\) See, inter alia: Avery Jones, J.F., & Bobbett, C., "Triangular Treaty Problems..."; Avery Jones, J.F., "The Interaction Between..." at p. 137 (Chapter 6, Section 6.4.1.); Gusmeroli, M., "Triangular Cases... Part 1."
\(^{1220}\) Avery Jones, J.F., & Bobbett, C., "Triangular Treaty Problems...".
\(^{1221}\) 2010 OECD Commentary on Article 4, para 8.2. This argument was first raised by the Dutch Under Minister of Finance when, in 1989, he refused to grant a certificate of residence to a dual-resident company incorporated in the Netherlands but having its place of effective management in Ireland. See: Betten, R., "Denial of Certificate..."
residence states. This interpretation is controversial however. This chapter assesses this interpretation and considers other ways in which the application of treaties concluded between the losing residence state and third states could be prevented. It also discusses the potential impact that a retrospective determination of residence under a tie-breaker rule may have on the application of treaties with third states.

**Scope**

It is quite clear that a dual resident person will remain resident in the winning residence state for the purposes of treaties concluded between that state and third states. It is also clear that where the tie-breaker rule of the treaty between the two residence states fails to assign residence to one state for the purposes of that treaty, the dual resident will remain resident in both residence states for the purposes of treaties concluded between those states and third states. The discussion in this chapter therefore deals only with the application (or non-application) of the treaty between the losing residence state and the source state.

**Abbreviations**

In this chapter, the state to which residence is assigned for the purposes of the treaty between the two residence states is referred to as the "winning residence state" (or "State W"), and the state to which residence is not assigned is referred to as the "losing residence state" (or "State L"). The third state where income arises is referred to as the "source state" or "State S." The treaty between the losing residence state and the source state is referred to as the "L-S treaty" and the treaty between the winning residence state and the source state is referred to as the "W-S treaty."

**11.2. The second sentence of Article 4(1)**

Under the second sentence of Article 4(1), a person will not be resident in a particular state for treaty purposes if they are only liable to tax in that state in respect of locally sourced income. The purpose of this provision is, in broad terms, to prevent persons who are taxed only on a source basis in a particular state from claiming treaty benefits. It is based the typical distinction between residence and source based taxation, however, as was seen in Chapter 5, this distinction is not always clear and it can be very difficult to apply in practice. This is certainly the case with respect to dual-residents, as will be seen below.

The second sentence of Article 4(1) provides that:

"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."

Determining whether the second sentence of Article 4(1) excludes dual-residents from eligibility under treaties between the losing residence state and third states requires consideration of three issues:

(i) Whether the treaty limitations on the tax imposed in the losing residence state should be taken into account for the purposes of applying the second sentence of Article 4(1) or whether consideration should be limited to the tax imposed under the domestic law of that state;

(ii) Assuming the treaty limitations are taken into account, whether the applicable treaty limitations will prevent the dual resident from being "liable to tax" in the losing residence state in relation to income which that state is prevented from taxing under the treaty between the two residence states (i.e., income arising in third states); and

(iii) Assuming items (i) and (ii) are answered affirmatively, whether the dual resident is liable to tax in that state "in respect only of income from sources in that State."

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These three issues will be discussed in turn below.

11.2.1. Whether treaty limitations should be taken into account

One of the key issues in determining whether a dual resident will be denied treaty benefits as a result of Article 4(1) is whether regard should be had only to the domestic law of that state, or also to the impact of the treaty between the two residence states. If consideration is limited to domestic law, then the second sentence of Article 4(1) would generally not prevent a dual resident person from being resident in the losing residence state for the purposes of treaties with third states (given that that person must have a sufficient liability under domestic law to be considered a resident under the treaty between the two residence states). It is only when the restriction under the treaty between the two residence states is taken into account that the dual resident may be denied treaty benefits.1223

There is no reference in the second sentence of Article 4(1) to domestic law which seems to indicate that the impact of tax treaties could be taken into account. However, the first sentence of Article 4(1) does refer specifically to domestic law and, since the second sentence refers back to (and limits) the first sentence, the better interpretation is therefore that the second sentence also refers only to domestic law.1224 To the extent that this is the case, a dual-resident would simply continue to be resident in the losing residence state for treaty purposes and could not be denied treaty benefits under the second sentence of Article 4(1) of the L-S treaty.

One difficulty with this interpretation is that the distinction between domestic law on the one hand and tax treaties on the other is not always clear from a legal perspective.1225 In some countries tax treaties are given effect by an act of Parliament and once enacted, become part of the domestic law,1226 while in others, treaties become part of domestic law by virtue of specific constitutional provisions.1227 Where tax treaties do form part of the domestic law of the losing residence state, there seems to be little justification for excluding the effect of the treaty between the two residence state when determining the scope of the tax liability in the losing residence state for the purposes of the L-S treaty. Nevertheless, a distinction could perhaps be drawn between domestic law and tax treaties on the basis that the basic rules of domestic law apply generally, whereas the provisions of a tax treaty apply only to residents of the other contracting state and do not have universal effect. In addition, the argument that tax treaties are in many cases part of domestic law could be applied equally to the first sentence of Article 4(1), which would clearly make a nonsense of the specific reference to "the laws of that state" included in that sentence. This direct reference does seem to imply that some distinction can be drawn between internal laws of one hand and tax treaties on the other, even if tax treaties are technically incorporated into the domestic law of the state involved from a legislative or constitutional perspective.

Avery Jones has argued that consideration should be limited to domestic law on the basis that, for the purposes of applying the second sentence of Article 4(1) of the treaty between the two residence states, the provisions of that treaty should not be taken into account (because otherwise one would never get to the tie-breaker) and therefore, the distributive provisions should similarly not be taken into account in applying the second sentence of Article 4(1) of other treaties.1228 The difference, however, is that before the distributive provisions of the treaty between the two residence states can be applied, residence must be determined under Article 4. It would be quite odd to apply the first sentence of Article 4(1) to determine whether an entity is resident in a particular contracting state, then apply the other distributive rules of the treaty on the basis that the person is resident in the other contracting state, before finally

1225 Sasseville, J., "A Tax Treaty Perspective...", at pp. 38-41 (Chapter 3, Section 3.2.) and (in the context of Article 4(1)) p. 44 (Section 3.3.). See also Vogel, who writes: "Under the theory of 'moderate dualism,' which seems to be generally accepted nowadays, international and domestic law are two spheres which exist separate of each other (save some exceptions). To exercise their intended influence on domestic law, treaties therefore have to be implemented by the domestic legislator. Thus, they receive the force of domestic law." (Vogel, K., "The Domestic Law...", at p. 3, (Chapter 1, Section 1.1.).
1226 In relation to the UK, see: Avery Jones, J.F., "The Interaction Between...", at p. 135 (Chapter 6, Section 6.3.).
1227 Sasseville, J., "A Tax Treaty Perspective...", at p. 39 (Chapter 3, Section 3.2.).
1228 Avery Jones, J.F., "The Interaction Between...", at p. 138, (Chapter 6, Section 6.4.1.).
returning to apply the second sentence of Article 4(1) for the ultimate determination of residence. It therefore does not seem inconsistent to consider the final result of the treaty between the two residence states (and thus the limitations on the losing residence state's taxing rights under that treaty) for the purposes of determining residence under other treaties, but to ignore it for the purposes of determining residence under that treaty itself.

One case where a tax treaty limitation was taken into account in determining treaty residence in a dual-resident triangular case was decided in the Netherlands in 2001.1229 This case involved a distribution of dividends1230 by a dual-resident company (i.e., a reverse dual resident triangular case), but the basic question to be decided was whether the dual-resident company was resident in the Netherlands (the losing residence state) under Article 4 of a treaty with a third state (in this case Belgium, the state where the shareholders were resident). It is therefore clearly also relevant to situations where a dual-resident company receives income from a third state.1231 The company involved was incorporated in the Netherlands but had its place of effective management in the Netherlands Antilles. Under the domestic laws of the Netherlands, the company was resident in the Netherlands, however, under the Tax Arrangement for the Kingdom of the Netherlands (which effectively operated as a tax treaty between the Netherlands and the Netherlands Antilles), the company was treated as a resident of the Netherlands Antilles and the Netherlands could only impose tax on certain items of income.1232 The court found that the company was not resident in the Netherlands for the purposes of the Belgium-Netherlands treaty because the company was not fully liable to tax in the Netherlands, i.e., taking into account the limitations imposed under the Tax Arrangement for the Kingdom of the Netherlands.1233 Importantly, however, a Protocol to the Belgium-Netherlands treaty contained a specific provision which stated that: "The expression, 'under the law of that State' used in Article 4 paragraph 1, means the law of that State as amended or supplemented by international agreements."1234 It is therefore not clear whether the limitations under a tax treaty between the two residence states should be taken into account for the purposes of applying treaties with third states that do not include a similar provision.

In summary, it is difficult to determine whether limitation on the losing residence state’s taxing rights under the treaty between the two residence states should be taken into account for the purposes of applying the second sentence of Article 4(1) and thus for determining whether a dual-resident company is entitled to the benefits of a treaty between the losing residence state and a third state, although I tend towards the view that consideration should be limited to domestic law (excluding tax treaties). Taking the treaty limitation into account for the purpose of applying the second sentence of Article 4(1) requires the distributive rules of one treaty (i.e., the W-L treaty) to effectively be read into a definition contained in another treaty (i.e., the L-S treaty), which is difficult to defend. Even if the tax treaty limitation is taken into account, however, it does not follow that treaty residence will be denied, since the application of Article 4(1) will also depend on whether the treaty limitation prevents the person involved from being "liable to tax" on income which the losing residence state is prevented from taxing and on the interpretation of "in respect only of income from sources in that state"; these factors will be discussed in the following sections.

1229 Decision in Case No. 35557, Supreme Court (HR) of 25 February 2001. For discussion of this case, see: Smit, P.M., "Treaty Residence..."; De Kort, J.W.J., "HR 28 February 2001..."; and Damen, S., "Netherlands Supreme Court...".

1230 Actually, it involved a purchase by the company of its own shares, but considered to be a dividend under Dutch tax law. See: De Kort, J.W.J., "HR 28 February 2001...".

1231 Damen, S., "Netherlands Supreme Court...".

1232 Smit, P.M., "Treaty Residence...".

1233 De Kort, J.W.J., "HR 28 February 2001...". This is despite the fact that, under the Belgium-Netherlands treaty which was in force at that time, Article 4(1) did not contain an equivalent to the second sentence of Article 4(1) of the OECD Model treaty. The treaty in force at the relevant time was the Belgium-Netherlands treaty concluded in 1970; Belgium and the Netherlands concluded a new treaty in 2001. This meant that the Netherlands could not impose any dividend withholding tax.

1234 Translation by: Smit, P.M., "Treaty Residence..."
11.2.2. Meaning of 'liable to tax'

The second issue which must be addressed in applying the second sentence of Article 4(1)\textsuperscript{1235} in the context of a dual resident is whether a treaty limitation which prevents a state from imposing tax on certain income will also prevent the person involved from being considered to be "liable to tax" in relation to that income. The phrase "liable to tax" is also used in the first sentence of Article 4(1) for the preliminary determination of whether a person is resident in a particular state. Although the context is slightly different, in that for the purposes of the first sentence of Article 4(1), being liable to tax is an attribute of the person whose residence is being determined, whereas in the second sentence the focus is shifted more to the income,\textsuperscript{1236} the interpretation of the phrase "liable to tax" in the first sentence may still shed some light on its proper interpretation in the second sentence.

As was discussed in Chapter 5, the extent of the liability to tax required in order for a person to be resident in a particular state under the first sentence of Article 4(1) is not always clear and, in particular, there is disagreement as to whether it has to be a full and comprehensive liability. However, it is clear that the requirement that a person be "liable to tax" does not require that the person have an actual tax liability.\textsuperscript{1237} For example, if the taxpayer has an overall loss, or if the country exempts certain items of income, this should not prevent the recipient of the income from being resident of that state under the relevant treaty. Interestingly, many countries take the view that entities that are tax exempt, such as pension funds and charities, can be resident for treaty purposes (and can be "liable to tax") on the basis that they are subject to the tax system of the country and are only exempt because they meet certain criteria for exemption.\textsuperscript{1238} A similar argument could be advanced in the case of dual residents with respect to the income which the losing residence state is prevented from taxing under the treaty between the two residence states. That is, for the purposes of the second sentence of Article 4(1), the "foreign source" income derived by the dual resident is subject to the tax system of the losing residence state, but is exempt because the person deriving the income meets certain conditions for non-taxation under the treaty between the two residence states. If this argument is accepted, the second sentence of Article 4(1) would only exclude from the definition of residence entities whose foreign income does not fall within the tax base in the state concerned. This may be a reasonable approach, and it does correspond to the general concept of source based taxation of non-residents. It would, however, be a very restrictive interpretation and would mean, for example, that even diplomats (the clear target of the provision\textsuperscript{1239}) would not be excluded from treaty residence under the second sentence of Article 4(1) in cases where their foreign income was included in the tax base of the host state but was then exempted under a specific provision or an international treaty (i.e., the 1961 Vienna Convention on Diplomatic Relations). Thus, the better interpretation seems to be that the dual-resident will not be "liable to tax" in the losing residence state on income which that state is prevented from taxing under the treaty between the two residence states (provided the treaty limitation is taken into account).

\textsuperscript{1235} A brief reminder of the wording of this sentence: "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 income from sources in that State or capital situated therein."

\textsuperscript{1236} Couzin, R., Corporate Residence…, at p. 109 (Section 3.1.1.1.).

\textsuperscript{1237} Vogel, K., Engelschalk, M. & Görl, M., Klaus Vogel on Double Tax Conventions…, at p. 229, (m.no. 24a).

\textsuperscript{1238} OECD Commentary to Article 4, paras 8.5 and 8.6. This view is not universally accepted.

\textsuperscript{1239} The second sentence of Article 4(1) was inserted in the 1977 version of the OECD Model in order to deal with the situation of diplomats posted abroad. Under Article 34 of the 1961 Vienna Convention on Diplomatic Relations, diplomats are granted an exemption from taxes in their host state with certain exceptions, including "taxes on private income having its source in the receiving state" (i.e., in the host state) (Article 34). Thus, the second sentence of Article 4(1) is intended to ensure that diplomats posted abroad are treated as resident in the sending state for treaty purposes instead of the receiving state, both for the purposes of the treaty between those two states (without having resorted to the tie-breaker rule) and for the purposes of treaties with third states. (See: the 1977 OECD Commentary on Article 4, para 8; Van Raad, K., "2008 OECD Model…"; Van Raad, K., "Dual Residence…")
11.2.3. Source of income

A key question in applying the second sentence of Article 4(1) in the context of dual-residents is the source of income. The argument advanced in the OECD Commentary is that, as a result of the treaty between the two residence states, the losing residence state is only entitled to impose tax on income from sources in that state.\textsuperscript{1240} The Commentary, referring to the second sentence of Article 4(1), states that:

\begin{quote}
"It also excludes companies and other persons who are not subject to comprehensive liability to tax in a Contracting State because these persons, whilst being residents of that State under that State’s tax law, are considered to be residents of another State pursuant to a treaty between these two States."\textsuperscript{1241}
\end{quote}

This will clearly depend, however, on the meaning of the phrase "liable to tax in that State in respect only of income from sources in that State" (emphasis added) and in particular, on how the source of income is determined for the purposes of applying this provision. As will be discussed below, the geographical source of income is by no means clear in the majority of cases. In this respect, Vogel writes:

\begin{quote}
"All this suggests that authors take ‘source’ to be a natural, self-defining concept about which not much dissent or disagreement is possible. However, this is far from the truth. ‘Source’ is unambiguously only in what it excludes: taxation based on ‘source’ is different from taxation based on residence or on citizenship. The only positive statement that can be made on the other hand is that ‘source’ refers to a state that in some way or other is connected to the production of the income in question, to the state where value is added to a good. In contrast, the type of connection that establishes the ‘source’ of income cannot be defined generally."\textsuperscript{1242}
\end{quote}

Most clearly in the present case, there is disagreement regarding whether the taxation of income which arises in a third state but is attributable to a PE in the losing residence state demonstrates that the dual resident is not "liable to tax in [the losing residence state] in respect only of income from sources in that State."\textsuperscript{1243}

11.2.3.1. Determining the source of income

The basic interpretive rule of Article 3(2) is that where a term is not defined in the treaty, it will take its meaning from the domestic law of the state applying the treaty, unless the context otherwise requires.\textsuperscript{1244} Since tax treaties based on the OECD Model do not contain a definition of "source," that term should, prima facie, take its meaning from the domestic law of the state applying the treaty. This firstly relies on that state applying the treaty having a definition of source in its domestic law, which may not always be the case, for example, tax may instead be imposed directly on certain types of income derived by non-residents without reference to source.\textsuperscript{1245} In addition, domestic law is likely to contain overlapping source rules with the result that a particular item of income may be considered to be sourced in two different

\textsuperscript{1240} OECD Commentary on Article 4, para 8.2.
\textsuperscript{1241} OECD Commentary on Article 4, para 8.2.
\textsuperscript{1242} Vogel, K., “Worldwide vs. Source… Part I.” Emphasis in the original.
\textsuperscript{1243} Van Raad, K., “Dual Residence and the 1977…”; Van Raad, K., "2008 OECD Model…”; Sasseville, J., "A Tax Treaty Perspective…", at p. 44 (Chapter 3, Section 3.3.). Van Raad argues that such income is sourced outside the losing residence state and thus, the dual-resident should continue to be resident there for the purposes of treaties with third states, while Sasseville argues the opposite, that such income can be considered to be sourced in the losing residence state. This will be discussed further below.
\textsuperscript{1244} Article 3(2) reads as follows: "As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State."
\textsuperscript{1245} Van Raad, K., “2008 OECD Model….” Van Raad proposed an approach whereby the application of the second sentence of Article 4(1) would be based on whether the income taxable in the losing residence state includes income that is taxable in the hands of non-residents under the domestic law the losing residence state. This would effectively deal with situations where domestic law does not contain a definition of source. It is problematic, however, because there seems to be no grounds for the source state to refer to the domestic law of the residence state to determine whether the treaty applies.
states under those rules, e.g., where passive income is derived in the context of business activities or where multiple factors are taken into account for the purposes of determining the source of particular types of income. Perhaps the most problematic aspect of relying on a domestic law definition, however, is that reference must be made to the domestic law of the state applying the treaty which, in any given situation, may be either of the two states. Where the source state is applying the treaty, treaty residence would depend on the source rules of that state, which should arguably not be relevant for determining whether an entity is resident in the other contracting state. Furthermore, where the source rules differ between the two states, the person involved may be considered to be a resident for the purposes of the treaty in one of the contracting states but not in the other. This would clearly be an inappropriate outcome.

These problems suggest that the better approach would be to consider this a situation where “the context otherwise requires” and thus where an international fiscal meaning should be applied. Given the wide diversity of source rules in different states,\(^{1246}\) it would be difficult to identify the source rules that should be applied. However, the determination of source could perhaps be based on the implicit source rules contained in the OECD Model,\(^{1247}\) i.e., on the basis that these rules reflect broadly accepted principles for determining the source of income. So, for example, dividends could be considered to be sourced in a particular state if they are paid by a resident of that state. The main difficulty with this approach is that the implicit sourcing rules in tax treaties generally do not identify a unique geographical source for each type of income. Dividends that are attributable to a PE, for example, could be considered to be sourced both in the state where the payor is resident under Article 10 (e.g., the source state) and in the state where the PE is located under Article 7 (e.g., in the losing residence state). Given the inherent difficulty in determining the source of income there will inevitably be some overlap regardless of the principles which are employed, with the result that certain items of income may be considered to be sourced in more than one state. Nevertheless, in most cases the losing residence state will be prevented from imposing tax on income which, in accordance with the implicit source rules in tax treaties, can be considered to be sourced in third states. Dividends, interest, and royalties arising in a third state (and not attributable to a PE in the losing residence state) for example, will fall under the distributive rule of Article 21 of the treaty between the two residence states and the losing residence state will be prevented from imposing tax. This will also be the case in respect of any business profits or "other income" not dealt with in other articles of the treaty, which the losing residence state will be prevented from taxing under Article 7 and Article 21, respectively, unless it is attributable to a PE in that state. Similarly, under Article 13, the losing residence state will generally be prevented from imposing tax on capital gains arising from the alienation of assets connected with third states.\(^{1248}\) Thus, the clearest example of a category of income which can be taxed in the losing residence state but which may be considered to be sourced in a third state is passive income arising in a third state and attributable to a PE in the losing residence state.

11.2.3.2. Interpretation of the second sentence of Article 4(1)

The taxation of income which arises in a third state but is attributable to a PE in the losing residence state gives rise to particular disagreements with respect to the application of the second sentence of Article 4(1). It also clearly illustrates the problems that arise in interpreting that provision. The main point of contention in the application of the L-S treaty to dual residents is whether the taxation of this type of income demonstrates that the dual resident is not "liable to tax in that State [i.e., the losing residence state] in respect only of income from sources in that State." On one hand, it is argued that such income is

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\(^{1246}\) See, for example, Vann, R., "International Aspects...," at pp. 734-749.

\(^{1247}\) Although the articles of the OECD Model do not contain explicit source rules, they do set out the circumstances under which each contracting state may impose tax on income derived by residents of the other contracting state which, in effect, operate as source rules. See, for example, the Introduction to the 2010 OECD Model, para 19, which describes a contracting state which is entitled to impose tax on income derived by residents of the other contracting state as the "state of source." See also: Vogel, K., "State of Residence...,"

\(^{1248}\) Under Article 13 of the treaty between the two residence states, the losing residence state will generally only be able to impose tax on capital gains arising from the alienation of (i) immovable property located in that state, (ii) movable property attributable to a PE located in that state, (iii) gains from the alienation of ships or aircraft operated in international traffic (but only if the place of effective management is located in that state), and (iv) gains from the alienation of shares deriving more than 50% of their value from immovable property located in that state.
sourced in a third state (i.e., the source state) and thus, the dual-resident is taxable in the losing residence state on income which is not sourced in that state and, as a result, treaty benefits should be available. On the other hand, it is argued that such income is sourced in the state where the PE is located (i.e., the losing residence state) and thus, that the taxation of such income should not prevent the denial of treaty benefits under the second sentence of Article 4(1). In this respect, Vann writes:

“In terms of the Model wording in the second sentence, the only way that the OECD view can stand is in effect by preferring the PE sourcing rule over the passive income sourcing rule and so regarding all of the PE income as sourced in the PE country, but no explanation is given for such a preference.”

In reality, this type of income is sourced both in the state where it arises and in the PE state, at least in accordance with the implicit sourcing rules of tax treaties. However, this does not solve the issue of whether the second sentence of Article 4(1) should apply to deny treaty benefits to a dual-resident. In fact, the alternative viewpoints with regard to this type of income clearly demonstrate that there are two possible interpretations of the second sentence of Article 4(1), namely:

(i) that it will apply (and thus treaty benefits will be denied) only if none of the income taxable in the losing residence state can be considered to have a source outside that state; and

(ii) that it will apply (and thus treaty benefits will be denied) as long as all the income taxable in the losing residence state can be considered to have its source there.

Under the first interpretation, treaty benefits would be allowed as long as income that is sourced in a state other than the losing residence state could be identified, even if that income can also be considered to be sourced in the losing residence state. Under the second interpretation, treaty benefits would only be allowed if it were possible to identify income taxable in the losing residence state but which cannot be considered to have its source there. Clearly these two interpretations would give the second sentence of Article 4(1) a wildly differing scope but, based on the wording of the second sentence of Article 4(1), both seem to be equally correct and there seems to be no grounds for preferring one interpretation over the other.

11.2.3.3. Conclusion

The case of dual-residents reveals a major flaw of the second sentence of Article 4(1), namely the amorphous nature of the source concept in international tax law and the possibility for a certain item of income to be considered to have its "source" in various geographic locations either under differing conceptions of source or, in some cases, even under the single set of source rules. The wording of the second sentence of Article 4(1) also means that it is open to two differing interpretations. In the context of dual resident triangular cases, the dual resident is, on one hand, taxable only on income that is sourced in State L, since it is not taxed on any income that is not sourced in State L, but equally, the dual resident is not taxable only on income sourced in State L, since it is also taxable on certain income that is sourced in third states. This also assumes that the treaty limitation will be taken into account for the purposes of applying the second sentence of Article 4(1), and that it will prevent the dual resident from being "liable to tax" in the losing residence state in relation to income which that state is prevented from taxing under the treaty between the two residence states. This is by no means certain. Given the lack of clarity in the application of the second sentence of Article 4(1), it does not seem appropriate to take the extraordinary step of denying treaty benefits to an entity that would otherwise be entitled to them (even if the source

1249 Van Raad, K., "Dual Residence and the 1977…; Van Raad, K., "2008 OECD Model….”
1250 Sasseville, J., "A Tax Treaty Perspective…,” at p. 44 (Chapter 3, Section 3.3.)
1251 Vann, R., "Liable to Tax…,” at p. 253 (Section 7.4.2.1.).
1252 Refer to the discussion in Chapter 6 (Section 6.2.1.) regarding the overlap in tax treaty sourcing rules in PE triangular cases, where it was concluded that there is an overlap in tax treaty sourcing rules where a PE derives income from a third state; that analysis applies equally here.
1253 This is the interpretation favoured by Van Raad. (Van Raad, K., "Dual Residence and the 1977…; Van Raad, K., "2008 OECD Model….” See also: Betten, R., "Denial of Certificate….”
1254 This is the interpretation favoured implicitly by the OECD Commentary on Article 4 (para 8.2.) and by Sasseville (Sasseville, J., "A Tax Treaty Perspective…,” at pp. 42-44 (Chapter 3, Section 3.3.))
state considers that such benefits should not be available) based on one of two equally defensible interpretations of the wording of that provision. In light of the difficulties with the interpretation of the second sentence of Article 4(1), this approach is not a satisfactory way of dealing with (potentially improper) claims for treaty benefits by dual resident persons.

11.3. Preventing dual residents from claiming dual treaty benefits

If dual residents are not denied treaty benefits under the L-S treaty as a result of the second sentence of Article 4(1), the question arises as to the circumstances in which treaty benefits should be specifically denied. There are two main reasons for denying the benefit of the L-S treaty to dual-residents. The first is to prevent the source state from being subject to multiple treaty conditions in respect of the same income, and the second is to deal with the potential for tax avoidance. Clearly, the considerations are different in circumstances where the dual-resident is, for example, simply incorporated in the losing residence state and is not taxed there on any income arising in third states, and situations where the dual resident has a PE in the losing residence state and the income attributable to the PE includes income which arises in a third state (i.e., where there is effectively a PE triangular case). In the first case, real treaty shopping concerns do exist and the application of the L-S treaty is more clearly inappropriate. In the second case, however, there are strong arguments for continuing to apply the PE-S treaty. The ideal solution would therefore be to deny treaty benefits to dual-resident companies (i.e., under the treaty between the losing residence state and the source state) but to effectively extend treaty benefits to PEs (as outlined in Chapters 7 through 9). In this way, the L-S treaty would generally apply only in circumstances where the losing residence state would be entitled to impose tax on the income in accordance with the terms of the treaty between the two residence states.

This section will focus on alternative ways in which treaty benefits could be denied to dual resident companies. However, one option would of course be for states to do nothing and simply continue relying on the second sentence of Article 4(1) as currently worded. The primary advantage of this approach is that the second sentence of Article 4(1), having been included in the OECD Model since 1977, is widely included in existing treaties. Thus, treaty benefits can be denied to dual resident companies through the interpretation of existing treaty provisions with no changes to tax treaties (or domestic law) being required. Given the significant time which it would take to renegotiate an entire treaty network to implement an alternative approach, an approach that can be applied under existing treaty provisions clearly presents an enormous advantage. The disadvantage of this approach is equally clear, however, in light of the difficulties surrounding the interpretation of the second sentence of Article 4(1) and its application in the context of dual residents.

11.3.1. Provisions included in domestic law

One way of preventing dual residents from claiming reductions in source-based taxation under treaties between the losing residence state and third states is for states to include a provision in their domestic law to the effect that a company will not be considered to be a resident for domestic law purposes if its residence is assigned to another state under the provisions of an applicable tax treaty. Such provisions are already included in the domestic laws of Canada, the UK and South Africa.

Section 250(5) of Canada's Income Tax Act provides that:

"Notwithstanding any other provision of this Act (other than paragraph 126(1.1)(a)), a person is deemed not to be resident in Canada at a time if, at that time, the person would, but for this subsection and any tax treaty, be resident in Canada for the purposes of this Act but is, under a tax treaty with another country, resident in the other country and not resident in Canada."1255

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1255 Paragraph 126(1.1)(a) deals with authorized foreign banks. It reads as follows: "(1.1) In applying subsections 20(12) and (12.1) and this section in respect of an authorized foreign bank, (a) the bank is deemed, for the purposes of subsections (1), (4) to (5), (6) and (7), to be resident in Canada in respect of its Canadian banking business"
A similar provision in the UK provides as follows:

"(1) A company which—

(a) would (apart from this section) be regarded as resident in the United Kingdom for the purposes of the Taxes Acts, and

(b) is regarded for the purposes of any double taxation relief arrangements as resident in a territory outside the United Kingdom and not resident in the United Kingdom,

shall be treated for the purposes of the Taxes Acts as resident outside the United Kingdom and not resident in the United Kingdom."^{1256}

The provision in South Africa is as follows:

" 'resident' means ... but does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic [of South Africa] and that other country for the avoidance of double taxation."^{1257}

The effect of such provisions is that a person who is resident under domestic law but who has their residence of allocated to another state for treaty purposes under a treaty tie-breaker rule ceases to be a resident under domestic law. Consequently, they will also not be resident in the state concerned (the losing residence state) for the purposes of treaties which that state has concluded with third states (since treaty residence depends on residence under domestic law). This approach is therefore very effective in preventing dual residents from claiming treaty benefits under treaties concluded between their losing residence state (the state implementing the provision) and third states. It may also be relatively easy to implement since it does not require any renegotiation of tax treaties. Several authors have argued that this may be the best way to deal with the problem of dual residents claiming treaty benefits under multiple treaties.^{1258}

One problem with this approach is that, while this type of provision prevents the state implementing it from being used in treaty shopping structures, it does not allow that state to refuse to apply reductions in source-based taxation to companies which are dual-resident elsewhere. Thus the beneficiary of such a provision in a treaty context is not the state that implements it, but rather, other states with which that state has concluded tax treaties. As a result, states may have no particular incentive to implement such a provision purely to resolve the issue of dual residents claiming treaty benefits, and may be reluctant to do so, particularly in light of the amount of work that would need to go into drafting the provision and ensuring that it does not give rise to any adverse consequences under domestic laws.^{1259} Most states have limited resources and would prefer to direct those resources towards matters that are of concern domestically, rather than towards developing a provision primarily benefiting other states.

Thus, the main difficulty with advocating an approach which prevent dual residents from claiming treaty benefits by incorporating the result of the treaty tie breaker into domestic law is therefore that the main impact in the state implementing the provision will be with respect to the application of its domestic laws. The effects of the provision in a domestic context will depend upon its interaction with other domestic laws of the state where it is enacted and, in light of the complexity of the tax laws of most countries,

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^{1256} Section 249, 1994 Finance Act.
^{1257} Section 1 of the Income Tax Act, 58 of 1962. This specific paragraph was introduced by amendment by Section 33(1) of Act No. 12 of 2003, with effect from 26 February 2003.
^{1258} Avery Jones, J.F., & Bobbett, C., "Triangular Treaty Problems…" (Avery Jones and Bobbett state that "It was generally agreed that the problems caused by two treaties applying to the receipts and payments of a dual resident taxpayer can best be solved by internal law." The members of the panel were: John Avery Jones, Moris Lehner, Kees Van Raad, Jacques Sasseville and David A. Ward.); Avery Jones, J.F., "The Interaction Between…," at pp. 138-140 (Chapter 6, Section 6.4.1); Sasseville, J., "A Tax Treaty Perspective…," at pp. 46-48 (Chapter 3, Section 3.4.).
^{1259} Although the wording of the provision could be quite simple, this would depend on the domestic laws of the state involved. It may be necessary to define how the denial of residence will interact with certain other provisions of domestic law (exceptions and provisos are included in both the Canadian and UK provisions) and it may also be necessary to implement transitional provisions to deal with the sudden change in residency status upon the new law coming into force, dealing with, e.g., exit taxes on unrealised capital gains, changes in administrative obligations.
adverse consequences may potentially arise despite the best efforts of the drafters to identify and prevent them. Couzin, discussing the Canadian provision, writes:

"There are numerous provisions in the Act, both substantive and procedural, that are fundamentally affected by the reclassification of a taxpayer as a non-resident person under Section 250(5)."\textsuperscript{1260}

Couzin then goes on to identify various issues that may arise in relation to the interaction between the Canadian Section 250(5) and other provisions of Canadian law.\textsuperscript{1261} One of these is the interaction between Section 250(5) and deemed residence rules for withholding tax purposes.\textsuperscript{1262} These provisions deem, e.g., a company whose business is carried on principally in Canada to be resident in Canada solely for the purposes of determining whether payments made by that entity should be subject to withholding tax (Subsection 212(13.2)).\textsuperscript{1263} The question arises as to which of these provisions should take priority; Couzin notes that the administrative position is that Section 250(5) should be considered to operate first, deeming the company not to be resident in Canada, and then subsection 212(13.2) will apply to deem the company to be resident in Canada for limited purposes.\textsuperscript{1264} He comments that while this seems correct from a policy perspective and "defensible as a matter of statutory construction" it does highlight the difficulty of coordinating various deeming rules.\textsuperscript{1265}

Another important implication of a provision like Section 250(5), deeming a person who is resident in another state under a treaty to be non-resident for the purposes of domestic law, is that it may trigger an emigration for tax purpose. Like many countries, Canada has rules to the effect that a company which ceases to be a resident is deemed to dispose of all its assets for fair market value, resulting in the taxation of unrealised gains (or losses).\textsuperscript{1266} Couzin notes that this provision could be triggered and could therefore result in a tax liability where, for example, two states reach an agreement regarding the company's residence under the mutual agreement procedure, i.e., without any intentional change in residence by the taxpayer.\textsuperscript{1267} Such a charge may be justified where the tax is intended to compensate for the fact that the gains will be outside the taxing net when realised at a later date and where the allocation of residence which prevents tax from being imposed (i.e., under the treaty), however, it does highlight the fact that a provision tying domestic residence to treaty residence is likely to have implications for the application of other provisions of domestic law. These implications should be taken into account in determining whether to implement such a provision and in drafting the provision itself.

States may also be reluctant to include a deemed non-residence provision in their domestic law for fear of relinquishing taxing revenue unnecessarily, given that residents tend to be taxed on a broader range of income than non-residents. However, there are likely to be few items of income which can be taxed in the losing residence state under the treaty between the two residence states but which would not be taxable in that state under domestic law when derived by a non-resident. Sasseville, after discussing the benefits of this type of provision, notes that it might well be "counter-intuitive for a tax administration to prefer that a person (company or individual) be considered a non-resident rather than a resident" particularly in light of the additional reporting obligations usually imposed on resident persons.\textsuperscript{1268}

It should also be borne in mind, however, that a deemed non-residence provision may in some cases be advantageous for domestic purposes. The Canadian provision, for example, was introduced not to deal with claims for treaty benefits by dual-residents, but to deal with the insertion of dual-resident holding companies between Canadian companies and their US parent companies for the purpose of avoiding

\textsuperscript{1260} Couzin, R., \textit{Corporate Residence...}, at p. 215 (Section 4.2.3.4.).
\textsuperscript{1261} Couzin, R., \textit{Corporate Residence...}, at pp. 213-218.
\textsuperscript{1262} Couzin, R., \textit{Corporate Residence...}, at pp. 213-214.
\textsuperscript{1263} Couzin, R., \textit{Corporate Residence...}, at pp. 213-214.
\textsuperscript{1264} Couzin, R., \textit{Corporate Residence...}, at p. 214.
\textsuperscript{1265} Couzin, R., \textit{Corporate Residence...}, at p. 214.
\textsuperscript{1266} Couzin, R., \textit{Corporate Residence...}, at pp. 216-217. Couzin also discuses a special tax imposed on a company becoming a non-resident by reference to the amount by which the company's net assets exceed its paid up capital. He notes that this special tax is, in effect, a surrogate for the dividend withholding tax that would be imposed if the company had distributed all its assets on liquidation, and is imposed at the same rate.
\textsuperscript{1267} Couzin, R., \textit{Corporate Residence...}, at pp. 216-217.
\textsuperscript{1268} Sasseville, J., "A Tax Treaty Perspective...", at p. 48 (Chapter 3, Section 3.4.).
Canadian withholding tax on dividends.\textsuperscript{1269} Thus, this type of provision may prevent other types of tax avoidance by preventing dual resident persons who are resident in another state for treaty purposes from claiming certain benefits which would otherwise be available under domestic laws. Resident companies may, for example, be able to obtain benefits under group relief or consolidation provisions, provisions exempting inter-corporate dividends, provisions that restrict withholding taxes to non-residents, provisions that allow residents to claim relief from international double taxation, or under provisions allowing certain deductions or granting allowances exclusively to residents.\textsuperscript{1270} In relation to individuals, the benefits available to residents may include personal allowances and the application of progressive tax rates.\textsuperscript{1271}

Ultimately, the decision as to whether a provision deeming a dual resident whose residence is assigned to another state under a treaty to be a non-resident for domestic purposes should be implemented in a particular state will most likely come down to the impact it would have on the application of the domestic laws of that state.\textsuperscript{1272} While a provision along these lines would certainly be a good way of dealing with (improper) claims for treaty benefits by dual-residents, its impact in a domestic context would likely be far greater than its impact in a treaty context and thus, domestic considerations are likely to take precedence. This is particularly evident given that this type of provision does not allow the state implementing it to refuse to apply reductions in source-based taxation to companies which are dual-resident elsewhere. In a treaty context the beneficiary of such a provision is not the state that implements it, but rather, the other states with which that state has concluded tax treaties.

\textbf{11.3.2. Provisions included in tax treaties}

Dual resident entities could be prevented from claiming treaty benefits under treaties concluded by their losing residence state with third states under specific provisions included in tax treaties. Such provisions could either clarify the application of the second sentence of Article 4(1) or, alternatively, could deny treaty benefits on the basis of a direct reference to the allocation of residence to a third state under a treaty with that third state. These two options will be discussed in turn below.

\textit{11.3.2.1. Alternative second sentence of Article 4(1)}

The second sentence of Article 4(1) of the 2006 US Model Treaty provides 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 income from sources in that State or of profits attributable to a permanent establishment in that State."

The Technical Explanation indicates that this reference to the profits attributable to a PE is intended to ensure that PEs cannot be considered to be residents for the purposes of the treaty.\textsuperscript{1273} However, it may also forestall some of the issues discussed above in relation to determining the source of income for the purposes of applying the second sentence of Article 4(1), given that it is in cases where there is a PE in

\textsuperscript{1269}\textsuperscript{1271} 2006 U.S. Model Technical Explanation, p. 14. The Technical Explanation states that: "A person who is liable to tax in a Contracting State only in respect of income from sources within that State or capital situated therein or of profits attributable to a permanent establishment in that State will not be treated as a resident of that Contracting State for purposes of the Convention. Thus, a consular official of the other Contracting State who is posted in the United States, who may be subject to U.S. tax on U.S. source investment income, but is not taxable in the United States on non-U.S. source income (see Code section 7701(b)(5)(B)), would not be considered a resident of the United States for purposes of the Convention. Similarly, an enterprise of the other Contracting State with a permanent establishment in the United States is not, by virtue of that permanent establishment, a resident of the United States. The enterprise generally is subject to U.S. tax only with respect to its income that is attributable to the U.S. permanent establishment, not with respect to its worldwide income, as it would be if it were a U.S. resident."
the losing residence state where the most difficult questions arise. By addressing the most obvious case of income which may be considered to be sourced in a third state, this alternate wording may make it easier to deny treaty benefits under the second sentence of Article 4(1). It does not, however, resolve the issues surrounding the determination of the source of income in a more general sense and, in addition, questions may remain regarding whether treaty limitations should be taken into account or whether consideration should be limited to domestic law. For these reasons, although this wording is an improvement on that of the OECD Model, it is not the preferred approach for preventing dual residents from claiming the benefit of treaties concluded by the losing residence state with third states.

11.3.2.2. Provision referring directly to treaties with third states

As an alternative to altering the wording of Article 4(1), treaties could include a provision which denies treaty benefits by direct reference to the allocation of residence under treaties concluded with third states. Such a provision could be worded as follows:

"Notwithstanding the other paragraphs of this Article, a person will not be a resident of a Contracting State if that person is, under a tax treaty concluded between that State and a third State, resident in the third State and not in the first-mentioned State."

This provision is designed to be included in the residence article of the treaty (i.e., Article 4 or its equivalent) and operates where the treaty in which it is included is the treaty between the losing residence state and the source state. The clear advantage of including specific provisions in tax treaties to prevent claims for treaty benefits by dual-residents is that it does so clearly and directly. It avoids, for example, the difficult interpretive questions regarding source of income that may arise if states seek to deny treaty benefits under the second sentence of Article 4(1). It is also effective only for treaty purposes, so does not give rise to the issues discussed above with respect to the interaction between a domestic deemed non-residence provision and other provisions of domestic law. The main disadvantage is the extended period of time that it would take to implement such an approach, given that it will only be effective in relation to those treaties that actually include the provision. Tax treaties generally have a very long life and a substantial period of time can elapse before a treaty is renegotiated. This makes this approach ineffective as a short-term solution.

One of the issues which may arise if the operation of the L-S treaty is completely excluded is that unrelieved double taxation may arise in situations where the losing residence state is entitled to impose tax on the income in accordance with the terms of the treaty between the two residence states, e.g., where there is a PE in that state. This suggests that either treaty benefits should be available in relation to third state income attributable to PEs (i.e., the application of the PE-S treaty in PE triangular cases) or, otherwise, the L-S treaty should continue to require the losing residence state to grant relief to the extent that that state is entitled to impose tax under the treaty between the two residence states. Such a provision could be worded as follows:

"Where paragraph X [the paragraph denying treaty benefits] applies, the Contracting State where the person would otherwise be resident shall continue to apply [Article 23A / Article 23B] as though that person were a resident of that State, and as though the Convention had been applied as such in both Contracting States."1274

This provision would require the losing residence state to grant relief for tax imposed in the source state, but would limit that relief in circumstances where the source state would have imposed less (or no) tax if it had applied the L-S treaty. That is, no relief would be required if the source state would have been prevented from imposing tax on the income if it had applied the L-S treaty and, if the credit method applies, the amount of the credit will be limited to the amount of tax that the source state could have

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1274 Note that if the contracting states are concerned about being obliged to grant relief in excess of the tax that the losing residence state would be entitled to impose under the treaty between the two residence states (i.e., because the restriction on that state's taxing rights under the treaty is not taken into account for the purposes of determining the relief available), then they could include a specific provision to avoid the risk of this occurring. However, on the basis of the analysis conducted in Chapter 3 (where it was concluded that when applying the relief provisions of one treaty, any restriction on the residence state's taxing rights should be taken into account – see Section 3.3.), such a provision should not be necessary.
imposed if it had applied the conditions of the L-S treaty in relation to the income. The relief will also naturally be limited to the amount of tax imposed in the source state and the amount of tax imposed in relation to the income in the residence state by the provisions of Article 23A or Article 23B, as applicable.

11.3.3. Conclusions
States should be encouraged to include provisions in their domestic law to the effect that a person will not be resident in that state if their residence is assigned to another state under a tax treaty. This is a simple and effective approach, but it has the disadvantage that such a provision does not allow the state implementing it to deny treaty benefits to dual residents. It is also important to take into account the interaction between this type of provision and the other provisions of domestic law. From a treaty perspective, its effect is instead felt in that state’s treaty partners. Thus, from the perspective of the state considering whether to implement such a provision, the consequences under domestic law are likely to take precedence over treaty considerations. A better approach, and one which may be much easier to implement in certain states, would be to include a specific provision in tax treaties to deny treaty benefits to dual-residents whose residence is assigned to a third state under a tax treaty with a third state. This is a clear and direct approach, and avoids the difficult interpretive questions associated with denying treaty benefits under the second sentence of Article 4(1). It would, however, require the renegotiation of tax treaties (or at least the negotiation of a protocol) and thus its full implementation would likely take decades.

11.5. Conclusions
Concern regarding improper access to tax treaties by dual-residents has led to the development of the view, expressed in the OECD Commentary on Article 4, that a dual resident will not be resident in the losing residence state for the purposes of treaties with third states as a result of the second sentence of Article 4(1). However, it is not clear that the treaty limitations should be taken into account for the purposes of applying this provision and its wording is open to two differing interpretations. In the context of a dual resident deriving income arising in a third state and attributable to a PE in the losing residence state, for example, the dual resident is, on one hand, taxable only on income that is sourced in State L, since it is not taxed on any income that is not sourced in State L, but equally, the dual resident is not taxable only on income sourced in State L, since it is also taxable on certain income that is sourced in third states. Given the amorphous nature of the source concept and the uncertainty in applying the second sentence of Article 4(1), it is not a good way of denying treaty benefits to dual-residents, although it does have the practical advantage that it relies on the wording of existing treaties.

One way of preventing dual residents from claiming reductions in source-based taxation under treaties between the losing residence state and third states is for states to include a provision in their domestic law to the effect that a company will not be considered to be a resident for domestic law purposes if its residence is assigned to another state under the provisions of an applicable tax treaty. This is a simple and effective approach, but it has the disadvantage that such a provision does not allow the state implementing it to deny treaty benefits to dual residents. From a treaty perspective, its effect is instead felt in that state’s treaty partners who are then able to deny treaty benefits when the state implementing the provision is the losing residence state. States should be encouraged to implement such provisions but, from the perspective of the state considering whether to implement such a provision, the consequences under domestic law are likely to take precedence over treaty considerations.

A better alternative would be to include a specific provision in tax treaties to deny treaty benefits to dual-residents whose residence is assigned to a third state under a tax treaty between the state that would otherwise be their residence state and that third state, i.e., by providing that they are not residents for the purposes of the treaty. This is a clear and direct approach, but it would require the renegotiation of tax treaties and thus its full implementation would likely take decades. This makes it problematic as a short term solution but, nevertheless, it would certainly be the best approach in the long term.

One of the issues associated with completely excluding the operation of this treaty is that unrelieved double taxation may arise in situations where the losing residence state is entitled to impose tax on the income in accordance with the terms of the treaty between the two residence states, e.g., where there is a
PE in that state. Such cases are effectively PE triangular cases; an entity resident in one state (the winning residence state) derives income which is attributable to a PE located in another state (the losing residence state) and which arises in a third state. The ideal solution would therefore be to deny treaty benefits to dual-resident companies (i.e., under the treaty between the losing residence state and the source state) but to allow treaty benefits in relation to income attributable to a PE in the losing residence state. In this way, the L-S treaty would generally apply only in circumstances where the losing residence state would be entitled to impose tax on the income in accordance with the terms of the treaty between the two residence states.