Triangular cases: The application of bilateral tax treaties in multilateral situations
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Chapter 13
Conclusions

13.1. Introduction

The purpose of this concluding chapter is to give an overview of the proposed solutions for the issues arising in triangular cases, as discussed in earlier chapters, and to draw the various aspects of the thesis together. To this end, it will discuss the proposed solutions for each of the various triangular cases in turn before briefly drawing some more general conclusions regarding the application of bilateral tax treaties in multilateral situations. An overview of the suggested provisions for dealing with triangular cases is included at the end of the chapter.

13.2. PE triangular cases

The majority of this thesis has focussed on PE triangular cases, situations where a person resident in one state (State R) derives income which is attributable to a PE in a second state (State PE) and which arises from sources in a third state (the source state, or State S).1364 PE triangular cases give rise to a number of issues as a result of the overlapping taxing claims of the three states involved. One of the main issues is the potential for unrelieved double taxation, given that both the source state and the PE state may be entitled to impose tax under their respective treaties with the residence state and that the residence state may not be in a position to provide sufficient relief.1365 The potential for unrelieved double taxation could be mitigated, however, by the provision of relief in the PE state for tax imposed in the source state.1366 The PE state does not have any direct obligation to provide relief but may have a relief obligation under the PE non-discrimination article (Article 24(3)) of its treaty with the residence state (the R-PE treaty). Nevertheless, the existence and scope of this obligation is subject to debate1367 and it would be preferable for the PE state to have an explicit obligation to provide relief.

There is also the important issue of the applicable treaty conditions in the source state. Under the existing treaty framework, the source state will generally be required to apply the conditions of its treaty with the residence state (the R-S treaty) and not those of its treaty with the PE state (the PE-S treaty).1368 Given the transfer of taxing rights to the PE state under the R-PE treaty, however, and a number of other factors discussed in detail in Chapter 5, the source state is arguably applying the wrong treaty conditions and should instead be required to apply the conditions of its treaty with the PE state.1369 The application of the treaty between the residence state and the source state can also give rise to opportunities for treaty shopping, since the source state may be required to apply the conditions of the treaty in situations where the residence state is prevented from imposing tax on the income and where little or no tax is imposed in the PE state.1370

13.2.1. Extension of treaty benefits to PEs1371

It is proposed that the issues arising in PE triangular cases be dealt with by allowing the person deriving the income to claim the benefit of the PE-S treaty in relation to the income attributable to the PE. If implemented, this would generally resolve the issues arising in PE triangular cases as follows:

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1364 For an overview of the application of tax treaties in PE triangular cases involving different types of income, refer to the analysis in Chapter 2.
1365 Refer particularly to the discussion in Chapter 3 (Section 3.2.).
1366 Refer to the analysis in Chapter 3 (Section 3.2.2.2.) demonstrating that relief in the PE state will prevent unrelieved double taxation.
1367 Refer to Chapter 4 for a discussion of relief in the PE state, focussing particularly on the potential relief obligation which the PE state may have under the non-discrimination provision of its treaty with the residence state.
1368 See, for example: OECD Committee on Fiscal Affairs, "Triangular Cases," at para 40.
1369 For a detailed analysis of the appropriate treaty conditions for the source state to apply, refer to Chapter 5.
1370 OECD Committee on Fiscal Affairs, "Triangular Cases," at para 21. See also: Van Weeghel, S., The Improper Use... at pp. 124-126.
1371 This section provides an overview of the discussion in Chapters 7, 8 and 9 and certain parts of Chapter 5 (namely, Section 5.2.6. regarding the potential for treaty shopping through PEs).
4. The source state would apply the conditions of its treaty with the PE state (the PE-S treaty) instead of the conditions of the R-S treaty in relation to the income attributable to the PE. The source state is therefore applying the more appropriate treaty conditions;

5. The PE state would be required to provide relief for tax imposed in the source state, using the method specified under the PE-S treaty (either exemption or credit). The provision of relief in the PE state would generally ensure, in conjunction with relief in the residence state, that there would be no unrelieved double taxation in PE triangular cases; and

6. The residence state would provide relief for tax imposed in the PE state and/or the source state to the extent that such relief is required to prevent unrelieved double taxation. This may take the form of either exemption or credit relief, depending on the terms of the applicable treaties and the category of income involved.

Applying the PE-S treaty to the income attributable to the PE, and thus effectively allowing the PE to claim treaty benefits, would represent a dramatic departure from the existing treaty principles. However, given the hybrid nature of the PE concept and the extent of the similarities between the taxation of PEs and the taxation of resident enterprises, the implications of this approach would perhaps be less drastic than they may appear at first glance. Applying the PE-S treaty in PE triangular cases would certainly represent less of a departure from the existing international tax framework than a solution based on the conclusion of multilateral treaties and would also have less of an impact on the distribution of taxing rights than a solution which prevents either the PE state or the source state from imposing tax in PE triangular cases.\footnote{1372}{Refer to Chapter 6 for a detailed discussion of these potential solutions for PE triangular cases.}

It is recognised, however, that states may not be willing to implement such a fundamental change in the personal scope of tax treaties, particularly in light of the perceived risk for tax avoidance and, in particular, the potential for treaty shopping through PEs (which is discussed further below).\footnote{1373}{The OECD’s 1992 report on PE triangular cases finds that “The majority of states are strongly opposed to such a solution (i.e., extending treaty benefits to PEs), above all because such states fear it might encourage ‘treaty shopping’...” (OECD Committee on Fiscal Affairs, “Triangular Cases,” at para 39).}

In this case, it would still be possible to resolve perhaps the most pressing issues by including provisions in tax treaties which (i) explicitly require the PE state to grant relief for tax imposed in the source state and (ii) exclude the operation of tax treaties in relation to income attributable to a PE in a third state in circumstances where the contracting states consider the application of the treaty to be improper (i.e., the R-S treaty). This would both ensure that there is no unrelieved double taxation and prevent abuse of the treaty between the residence state and the source state. However, the source state would continue to apply the less appropriate treaty conditions to the income attributable to the PE.

\subsection*{13.2.1.1. Approaches to extending treaty benefits to PE}\footnote{1374}{For further discussion of the possible approaches to extending treaty benefits to PEs, refer to Chapter 7 (Section 7.3.).}

There are two primary ways of extending treaty benefits to PEs, which are distinguished by the way in which the conditions PE-S treaty are made to apply. These two approaches are as follows:

3. The direct approach: The source state is required to apply the conditions of the PE-S treaty in relation to income attributable to the PE and the PE state is required to grant relief (either exemption or credit) for tax imposed in the source state by provisions included directly in the PE-S treaty.

4. The indirect approach: The source state is required to apply the conditions of the PE-S treaty indirectly by provisions included in the R-S treaty. The PE state is required to provide relief for tax imposed in the source state (either exemption or credit) under specific provisions included in the R-PE treaty.

It may also be possible to extend treaty benefits to PEs unilaterally under domestic law, under the mutual agreement article of the PE-S treaty, or under provisions included in all three treaties; these alternative
options were discussed in detail in Chapter 7. However, applying the PE-S treaty directly under its own terms is clearly preferable to the other alternatives. It results in the PE being treated, as closely as possible, in the same way as a resident enterprise of the PE state and ensures neutral treatment of PEs located in a particular state (i.e., the PE state) and deriving income from another state (i.e., State S), regardless of the residence state of the entity as a whole. It also ensures that the split of tax revenue between the PE state and the source state in relation to income from cross-border activities is a product of the provisions of the treaty negotiated between those two states. Furthermore, in contrast to the indirect approach, the direct approach avoids the potential for unbalanced applications of the PE-S treaty due to a partial implementation, i.e., where the PE-S treaty is applied in only one of the contracting states.

13.2.2. Proposed treaty provisions

The treaty provision extending treaty entitlement to PEs could be worded as follows:

"(1) For the purposes of this Convention, notwithstanding the provisions of Article 1 (Persons Covered),

(a) where a person, who is not a resident of either of the Contracting States, has a permanent establishment in one of the Contracting States for the purposes of a convention between Contracting State where the permanent establishment is located and a third state, then this Convention shall apply to any income included in the profit attributable to the permanent establishment (for the purposes of the convention between the Contracting State where the permanent establishment is located and the state where the person is resident) as though that income were income of a resident of the Contracting State in which the permanent establishment is located. However, this Convention shall not apply to income which the Contracting State where the permanent establishment is located is prevented from taxing under the convention between that State and the person’s residence state or between that State and a third state.

(b) where a person who is not a resident of either of the Contracting states, carries on business in State A through a [permanent establishment] (as defined under the laws of State A) and that person is not considered a resident of a third state for the purposes of a convention between State A and that third state, then this Convention shall apply to any income included in the profit attributable to the [permanent establishment] (under the domestic law of State A) as though that income were income of a resident of State A. However, the Convention shall not apply under this paragraph to income which State A is prevented from taxing under a convention with a third state.

(c) where a person who is not a resident of either of the Contracting states, carries on business in State B through a [permanent establishment] (as defined under the laws of State B) and that person is not considered a resident of a third state for the purposes of a convention between State B and that third state, then this Convention shall apply to any income included in the profit attributable to the [permanent establishment] (under the domestic law of State B) as though that income were income of a resident of State B. However, the Convention shall not apply under this paragraph to income which State B is prevented from taxing under a convention with a third state.

(2) This Article shall apply to capital gains and to profits in the same way as it applies to income.

(3) Any income, capital gains or profits to which this Convention applies as a result of paragraph 1 shall be considered to be paid to, derived by and beneficially owned by a person who is a resident of the Contracting State where the permanent

1375 Refer to Section 7.3.
establishment, [equivalent term in State A] or [equivalent term in State B] is located for the purposes of the application of this Convention under paragraph 1.

Paragraph 1(a) of this provision applies where the enterprise to whom the PE belongs is resident in a state which has concluded a treaty with the PE state. Paragraphs 1(b) and 1(c), on the other hand, apply in cases where the enterprise is not resident in a state which has a treaty with the PE state, in keeping with the view that the residence state of the enterprise is not relevant to the extension of treaty benefits to the PE.1376 However, where these paragraphs apply, treaty benefits should be available on the basis of the PE threshold of domestic law (or an equivalent domestic threshold) being satisfied. The wording of these provisions would therefore have to be adapted to refer specifically to the domestic laws of each of the contracting states. Alternatively, the contracting states could exclude these paragraphs and apply the PE-S treaty only in situations where there is a treaty in place between the residence state and the PE state.

Paragraph 2 of this proposed provision ensures that it applies to business profits and capital gains in the same way as it applies to other types of income. Paragraph 3 is included to ensure that the various articles of the OECD Model will apply regardless of the varying terms used to establish their application,1377 and to ensure that the treaty is applied as though the income were beneficially owned by a resident of the PE state (as discussed below). The following sections highlight other key aspects of the operation of this provision.

13.2.2.1. Person claiming the benefit of the provision

It is sometimes suggested that treaty benefits should be extended to PEs by expanding the definitions of "person" and/or "resident" (in Articles 3 and 4, respectively) in such a way that PEs would become treaty-eligible resident persons.1378 This approach implies that it is the PE itself which claims the benefits of the treaty, rather than the entity to which it belongs. Allowing the PE to claim treaty benefits on its own account would be fully consistent with treating the PE as a separate entity and would generally result in the treaty being applied to PEs in the same way as it applies to persons resident in the PE state. However, treating the PE as a person for treaty purposes and allowing it to claim treaty benefits directly is likely to result in a mismatch between the "person" claiming treaty benefits and the person upon whom tax is imposed under the domestic laws of the states involved. These problems could be avoided relatively easily by structuring the provision in such a way that it is the entity to which the PE belongs who claims treaty benefits under the PE-S treaty in relation to the income attributable to the PE and the provision outlined above is worded in this way.1379 One consequence of this approach is that the person claiming treaty benefits is not resident in either of the contracting states, and therefore does not fall within the personal scope of the treaty. The provision outlined above is therefore worded to operate as an exception to Article 1 ("…notwithstanding the provisions of Article 1…").1380

13.2.2.2. Income must be attributable to a PE for the purposes of the R-PE treaty

If specific provisions are included in the PE-S treaty to extend treaty benefits to PEs, they should only apply in circumstances where there is a PE in the PE state for the purposes of the R-PE treaty, and the income is attributable to that PE.1381 However, if no specific reference is made to the R-PE treaty then the applicable PE definition will be that contained in the PE-S treaty. The first paragraph (paragraph 1(a)) of the proposed provision therefore refers specifically to the R-PE treaty, and ensures that it applies only

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1376 This is discussed in detail in Chapter 8 (see Section 8.3.1.1.). The main reason for considering the residence of the person to be irrelevant is that, after the provision of relief under the applicable tax treaties, the residence state is likely to either exempt the income or impose only a small amount of residual taxation. The fact that no tax is imposed in the residence state should therefore have no impact on the availability of treaty benefits to the PE and, as a result, there seems to be no reason to limit treaty benefits to PEs which belong to a person resident in a state that has a treaty with the PE state.
1377 Refer to Chapter 8 (Section 8.2.5.) for a brief overview of the various terms used the OECD Model.
1378 See, for example: Yong, S., “Triangular Treaty Cases…”; Langoth, B. “Treaty Entitlement…”
1379 For further discussion, see Chapter 8 (Section 8.2.1.).
1380 For further discussion, see Chapter 8 (Section 8.2.2.).
1381 For further discussion refer to Chapter 8 (Section 8.2.3.).
in situations where the income is attributable to a PE in the PE state for the purposes of the R-PE treaty. This ensures that no mismatches occur with respect to the existence of a PE between the application of the R-PE treaty and the application of the PE-S treaty.

13.2.2.3. No treaty benefits if PE state prevented from imposing tax

The proposed provision outlined above also includes wording to the effect that treaty benefits will not be available to the PE in relation to income which the PE state is prevented from taxing under its treaty with the residence state. This may potentially occur, for example, in relation to income from shipping and air transport (under Article 8), where the distribution of taxing rights does not depend on the existence of a PE. Clearly the conditions of the treaty between the PE state and the source state should not apply in these circumstances, even if the income is attributable to a PE in the PE state.

13.2.2.4. Residence and beneficial ownership

Before an entity is eligible for reductions in source-based taxation under a tax treaty, it must generally be resident in one of the contracting states and, in relation to dividends, interest and royalties, it must be the beneficial owner of the income. However, these requirements should arguably not apply in the case of a PE claiming treaty benefits. In a PE triangular case, it is likely that the income attributable to the PE will either not be taxed at all in the residence state (e.g., if the residence state exempts the income) or will be only minimally taxed (e.g., if the residence state grants credit relief). This is the case regardless of whether the residence state is a high or low taxing country or is, indeed, a tax haven. The state in which the entity to which the PE belongs is resident should therefore not have any influence on whether treaty benefits are available to the PE. For this reason, the entity as a whole should not be required to satisfy any residence requirement in order for the PE to be entitled to treaty benefits. It follows that the entity to which the PE belongs should also not be required to be the beneficial owner of the income, since the residence of the beneficial owner is not relevant for determining whether treaty benefits should be available to the PE.

A PE should also not be required to satisfy any additional "residence-type" criteria (i.e., at the level of the PE) in order for the PE-S treaty to apply. Arguably, a resident enterprise is effectively created in the PE state as a result of the PE being located there, and thus, the existence of a PE and the attribution of income to that PE should be sufficient. Furthermore, the direct application of a beneficial ownership concept to PEs is not feasible because PEs are generally not separate legal entities. Rather than trying to adapt the beneficial ownership concept to apply to PEs, the best approach would simply be to rely on the existing concepts which are used for determining the profit attributable to the PE. These concepts are well developed and result in an allocation of income to the PE on an economic basis, linked to the activities carried out by the PE. Assets giving rise to passive income, for example, will only be economically owned by a PE if active decision making with regard to whether to make the investment, and the ongoing management of the investment, is undertaken by personnel working in the PE. This is clearly a much higher standard than is required in order for income to be earned (and beneficially owned) by a subsidiary company. Consequently, where income is attributable to the PE for treaty purposes, this connection to the activities of the PE should be sufficient to entitle the PE to claim reductions in source based taxation on dividends, interest and royalties under the PE-S treaty without the need for any additional beneficial ownership-type requirement to be satisfied. The proposed provision outlined above therefore deems the income attributable to the PE to be beneficially owned by a resident of the PE state for the purposes of applying the treaty.

1382 This section gives an overview of the discussion in Chapter 8, Section 8.3.
1383 In accordance with the residence definition contained in the treaty (in the OECD Model, Article 4).
1384 See: OECD Model, Article 10 (2), Article 11(2) and Article 12(1).
1385 Refer to the discussion in Chapter 8, Section 8.3.1.1.
1386 Refer to the discussion in Chapter 8, Section 8.3.2.1.
1387 This was discussed in Chapter 5, see Section 5.2.4.
13.2.2.5. Certification procedure

Claims for treaty benefits must typically be supported by an endorsement from the residence state of the person claiming treaty benefits, usually in the form of a residence certificate. Where a PE is claiming treaty benefits, the PE state should clearly be involved in this process, since the PE state is effectively functioning as the residence state with respect to that claim for treaty benefits. The residence state should also be involved, however, as this would facilitate the application of the R-S treaty, particularly in cases where that treaty incorporates provisions dealing with PE triangular cases, although the residence states' involvement would not be essential since, as discussed above, the availability of the PE-S treaty would not depend on the residence of the person as a whole. The development of a certification procedure for treaty claims in relation to the income attributable to PEs would not require specific provisions to be included in the treaty, but a standard procedure should be developed. Under this procedure, the PE state would certify that the person involved has a PE in that state for the purposes of the R-PE treaty and that the income is attributable to that PE. The residence state on the other hand, if it is involved, would certify that the person involved is resident in that state and that the income in question is attributable to a PE in the PE state. These certifications would generally have to be based on representations from the person involved, but would at least ensure that the taxpayer is making consistent representations in all three states.

13.2.3. Potential for improper access to treaties through PEs

One of the main concerns with extending treaty benefits to PEs is the potential for tax avoidance and, in particular, the potential for treaty shopping through PEs. States face significant challenges in combating treaty shopping under existing principles and for this reason, they may be understandably reluctant to open up a further avenue for claiming treaty benefits. Nevertheless, concerns about treaty shopping through PEs may be offset by the fact that the income of a PE is determined through a process of allocation, requiring a determination of the amount of income that is properly attributable to the PE on an economic basis. As a result, states may actually find it easier to challenge what they consider to be improper claims for treaty benefits when those claims involve PEs than when they involve legal entities. In general, a much greater level of activity would generally be required in the PE state in order for the income to be properly attributable to the PE than that which would be required for a legal entity to be the beneficial owner of income. Where this standard has been met, and it has been agreed that the income is economically the income of the PE and arises from the PEs activities, it seems difficult to accept that the source state may refuse to apply the conditions of the PE-S treaty. In addition, the risk of treaty shopping could be further reduced by including specific provisions in tax treaties to prevent PEs from claiming treaty benefits in situations where such a claim would be considered improper.

13.2.3.1. Specific provisions aimed at preventing improper access to treaties through PEs

The OECD Commentary on Article 1 suggests various provisions that could be included in tax treaties to combat treaty shopping, a number of which could be adapted to deal with improper claims for treaty benefits through PEs. Set out below is an overview of these provisions, which are discussed in greater depth in Chapter 8. Suggested wording for the provisions is given at the end of this chapter.

Subject-to-tax provisions:
A provision could be included in the PE-S treaty to the effect that any exemptions or reductions available to a PE under the treaty will only apply if the income in question is taxable in the PE state under the ordinary rules of that state’s tax law. Preferably, however, the provision...
could operate by reference to the tax that would be imposed on a resident enterprise deriving the same income.

**Anti-base erosion provisions (the "channel approach"):** A base erosion test for PEs could provide that a PE will only be entitled to treaty benefits if, for example, less than 50% of the income attributable to the PE is paid or accrued to persons who are not resident in either of the contracting states in the form of payments that are deductible, including notional payments to other parts of the enterprise to which the PE belongs, but excluding arm’s length payments in the ordinary course of business for services or tangible property.

**Denial of benefits where there is a tax avoidance motive:** A specific provision may deny reductions in source-based taxation in relation to dividends, interest, royalties and other income which would otherwise be available to the PE if "it was the main purpose or one of the main purposes of any person concerned with," for example, any actions which cause the income to be attributable to a PE in one of the Contracting States, in order to obtain a reduction in source-based taxation under the treaty. The exact wording of this type provision would have to be determined by the contracting states, who may wish to give further consideration to the types of activities or actions which would be taken into account when applying the provision.

**Safe harbour provisions:** Where the PE-S treaty contains specific anti-abuse provisions, such as those outlined above, it should also include safe harbour provisions to allow PEs to claim treaty benefits in situations where such claims would be considered legitimate but which nonetheless trigger a denial of treaty benefits under a specific anti-abuse provision included in the treaty.

### 13.2.4. Excluding the operation of the R-S treaty

One of the primary concerns that arises in relation to PE triangular cases under the existing treaty framework is the potential for improper claims for treaty benefits. That is, the source state may be required to reduce the amount of tax it imposes on income as a result of the application of the R-S treaty in situations where the income is exempt in the residence state by virtue of being attributable to a PE located in a third state, and where the PE state imposed no (or minimal) tax on the income.

Various existing treaties contain provisions which are intended to counteract claims for treaty benefits in relation to income attributable to a PE in a third state in certain circumstances that are considered to be abusive. These provisions generally exclude the normal reductions in source-based taxation under the treaty where income is attributable to a PE located in a third state, and commonly contain exceptions for situations which are not considered to be abusive. The inclusion of a specific provision in tax treaties to exclude treaty benefits in relation to income which is attributable to a PE in a third state has a number of advantages. It allows the states involved to specify the situations which they consider to give rise to improper claims for treaty benefits, and to prevent claims for treaty benefits in such cases. In comparison to an approach which is based, for example, on the application of domestic anti-avoidance measures, the inclusion of a specific provision in the treaty means that there is no need for the tax authority of the source state to identify the situation and challenge the claim for treaty benefits, which may or may not be successful. In addition, where treaty benefits are denied under a specific provision of the tax treaty, there is no question of whether or not the source state has failed to meet its treaty obligations by denying benefits. Specific provisions also give taxpayers greater certainty as to the way in which the treaty will apply in their particular circumstances.

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1397 Refer to the discussion in Chapter 8 (Section 8.4.3.). See also the suggested provisions in the OECD Commentary on Article 1, para 17 and para 20 (clause 2(c)).

1398 Refer to the discussion in Chapter 8 (Section 8.4.4.).

1399 Refer to the discussion in Chapter 8 (Section 8.4.6.). See also: OECD Commentary on Article 1, para 19.

1400 This section gives an overview of the discussion in Chapter 7, Section 7.5.


1402 For a detailed discussion of these provisions, refer to Chapter 7 (Section 7.5.1.1.).

1403 For discussion of the potential for the application of domestic anti-avoidance measures in a treaty context to contravene international law, see: Arnold, B.J., & Van Weeghel, S., "The Relationship Between...."
If treaty benefits are extended to PEs, then in addition to dealing with treaty shopping concerns, the exclusion of the normal provisions of the PE-S treaty in relation to income attributable to a PE in a third state would serve to prevent the source state from being subject to multiple treaty restrictions with respect to the same income.\footnote{Refer to the discussion in Chapter 7 (Section 7.5.2.).} In order to deal with situations where there is either no PE-S treaty or the PE-S treaty does not apply, the best approach would be to combine a provision excluding the operation of the R-S treaty in cases where the PE-S treaty applies with a provision along the lines of those included in existing treaties which excludes its operation in situations where access to the treaty is considered improper. This would prevent the source state from being obliged to apply the conditions of the R-S treaty in what may be considered abusive situations, but would allow the R-S treaty to continue to apply in situations where the source state doesn't apply the conditions of the PE-S treaty and the application of the R-S treaty is not considered improper.

Thus, ideally, the R-S treaty would include provisions to the effect that its conditions do not apply in relation to income attributable to a PE in a third state if either:

3. The source state applies the conditions of the PE-S treaty in relation to that income; or

4. The source state does not apply the conditions of the PE-S treaty, but the situation is one where the application of the conditions of the R-S treaty would be considered improper.

A provision excluding the application of the R-S treaty in the above circumstances could be worded along the following lines:

"(1) Where an enterprise of a Contracting State derives income from the other Contracting State, and that income is attributable to a permanent establishment which that enterprise has in a third state for the purposes of a convention between the Contracting State of the enterprise and that third state, the tax benefits which would otherwise be available under the other provisions of this Convention will not apply to that income if the profits of the permanent establishment are subject to a combined aggregate effective rate of tax in the first-mentioned Contracting State and third state that is less than [60] percent of the general company tax rate applicable in the first-mentioned Contracting State. Any dividends, interest or royalties to which the provisions of this paragraph apply shall be subject to tax in the other Contracting State at a rate that shall not exceed [15] percent of the gross amount thereof. Any other income to which the provisions of this paragraph apply shall be subject to tax under the provisions of the domestic law of the other Contracting State, notwithstanding any other provision of the Convention. The provisions of this paragraph shall not apply if:

a) In the case of royalties, the royalties are received as compensation for the use of, or the right to use, intangible property produced or developed by the permanent establishment itself; or

b) In the case of any other income, the income derived from the other Contracting State is derived in connection with or is incidental to, the active conduct of a business carried on by the permanent establishment in the third state (other than the business of making, managing or simply holding investments for the enterprise's own account).

(2) Where an enterprise of a Contracting State derives income from the other Contracting State, and that income is attributable to a permanent establishment which that enterprise has in a third state for the purposes of a convention between the Contracting State of the enterprise and that third state, the tax benefits which would otherwise be available under the other provisions of this Convention will not apply to that income if the other Contracting State applies the conditions of a convention between that State and the third state in relation to that income."

Paragraph 1 of this provision is based on the wording of the provisions of certain US treaties, with minor modifications. One of these modifications clarifies that the provision applies if, and only if, a PE exists.
for the purposes of the R-PE treaty. The second paragraph ensures that the R-S treaty does not apply in situations where the source state applies the conditions of its treaty with the PE state.

13.2.4.1. Continued relief obligation in the residence state

Where the residence state exempts the income attributable to the PE, there will be no need for any additional relief in the residence state. However, where the residence state uses the credit method in relation to the income attributable to the PE, then unrelieved double taxation may persist unless the residence state continues to grant relief in accordance with the provisions of the R-S treaty. To preserve the operation of the relief provisions of the R-S treaty in the residence state, treaties could include the following paragraph (in addition to those outlined above):

"(3) Where the tax benefits which would otherwise be available under the other provisions of this Convention do not apply as a result of paragraph 1 or paragraph 2, the Contracting State where the person deriving the income is resident shall continue to apply [Article 23A/ Article 23B]. However, that State shall not apply [Article 23A/Article 23B] if the other Contracting State is prevented from imposing tax on the income under the terms of a convention with a third state. Where a Contracting State applies [Article 23A / Article 23B] under this paragraph, it shall be applied as though the other Contracting State has applied the other provisions of this Convention in relation to the income."

This provision requires the residence state to continue applying the relief provisions of the R-S treaty, but allows it to apply those provisions as though the source state had also applied the conditions of the treaty. This means, for example, that the residence state will not be obliged to provide relief in relation to income which the source state would have been prevented from taxing if it had applied the conditions of the R-S treaty (e.g., where it is not prevented from taxing under the PE-S treaty). It also means that, in relation to passive income, the residence state will not be obliged to provide credit relief for any tax in excess of the amount the source state could have imposed under the R-S treaty. Where the residence state grants credit relief, the amount of the credit will also naturally be limited to the amount of tax actually imposed in the source state by the existing wording of the relief provisions. Furthermore, the proposed provision does not require the residence state to apply the relief provisions of the R-S treaty if the source state is prevented from imposing tax under the terms of the PE-S treaty; this is particularly relevant where the residence state uses the credit method under the R-PE treaty and the exemption method under the R-S treaty.

It is also important to keep in mind the interaction between the relief provision of the R-S treaty and the relief provisions of the R-PE treaty. In general, if one or both of the two applicable treaties requires the residence state to provide relief using the exemption method, then the residence state must simply exempt the income. Similarly, if the two treaties provide for different methods of relief, then the residence state must generally exempt the income. The residence state will only provide credit relief, therefore, if both the applicable treaties provide for credit relief.

13.2.5. Conclusions

In PE triangular cases, there are essentially three main issues which must be resolved; the potential for unrelieved double taxation, the potential for improper access to the treaty between the residence state and the source state, and the application of the appropriate treaty conditions in the source state. The best way to resolve these issues would be to allow the person deriving the income to claim the benefits of the treaty between the PE state and the source state in relation to the income attributable to the PE, i.e., to extend treaty benefits to PEs. This would ensure that the source state applies the more appropriate treaty conditions and that the PE state grants relief for tax imposed in the source state, thus preventing unrelieved double taxation. Although it has been concluded that the additional risks of treaty shopping in this scenario are minimal, due primarily to the economic basis for the attribution of income to PEs, the extension of treaty benefits to PEs could be supplemented by provisions preventing PEs from claiming treaty benefits in situations where a claim would be considered improper. The application of the PE-S treaty should also be accompanied by provisions excluding the operation of the R-S treaty, both in
situations where the source state applies the conditions of the treaty with the PE state, and in other situations where the application of the treaty would be considered improper.

One of the major considerations with effectively extending treaty benefits PEs is the extent to which PEs should be treated as separate enterprises for treaty purposes. A logical consequence of treating a PE as a separate enterprise for the purposes of determining the applicable treaty conditions to apply in the source state is that the PE should also be treated as a separate enterprise for other purposes of the treaty, e.g., allowing source-based taxation of notional payments by the PE. However, as discussed in Chapter 9, this can lead to absurd results and would ultimately result in an enormous level of complexity for little practical benefit, despite its theoretical consistency. This suggests that a line should still be drawn beyond which a PE is not treated as a separate enterprise for treaty purposes. Under existing tax treaties this line is drawn at the attribution of profit, with PEs being treated as separate enterprises only for profit attribution purposes. What is proposed here is simply to shift that line such that the PE is also effectively treated as a separate enterprise for determining the applicable treaty conditions to apply in relation to foreign source income attributable to the PE (i.e., the PE-S treaty), without treating PEs as separate enterprises for the purposes of the entire treaty.

13.3. Dual resident triangular cases

Dual resident triangular cases occur where a dual resident person receives income from sources in a third state (the "source state"). For treaty purposes, residence is determined in accordance with Article 4 (or its equivalent) by reference to residence under domestic laws and thus, 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. However, in some situations the applicable tie-breaker rule may not effectively assign residence to a particular state and the person involved may continue to be a dual-resident for the purposes of the treaty. This is particularly likely in the case of companies given the uncertainties involved in the application of the "place of effective management" tie-breaker rule, for example, in cases where management activities are split between different states. Where there is no effective allocation of residence for the purposes of the treaty between the two residence states, it is not clear how that treaty should be applied and unrelieved double taxation may arise both in bilateral and multilateral situations.

Even where the tie-breaker rule of the treaty between the two residence states does effectively assign residence to one state, that assignment will generally only be effective for the purposes of that treaty. 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. This means that in a triangular situation a dual resident may be entitled to claim treaty benefits 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

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1405 Dual resident triangular cases are discussed in Chapter 9, which contains an analysis of dual resident triangular cases involving different categories of income, and in Chapter 10, which deals primarily with the application of treaties between the losing residence state of the dual-resident and third states.
1406 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). These tie-breaker rules are discussed in Chapter 10 (Section 10.3).
1407 For an analysis of how the treaty between the two residence states may apply if the tie-breaker does not effectively assign residence to one state, refer to Chapter 10 (Section 10.4.1).
1408 The place of effective management tie-breaker is discussed in Chapter 10, Section 10.3.2.1.
1409 Refer to Chapter 10 (Section 10.4.1).
1410 Refer to the discussion in Chapter 10 (Section 10.4.2.2.) and in Chapter 11.
1411 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.).
treaty conditions that are more favourable to the person deriving the income.\footnote{See, inter alia: Van Raad, K., "The 1992 OECD Model…"; Avery Jones, J.F., & Bobbett, C., "Triangular Treaty Problems…"; Gusmeroli, M., "Triangular Cases… Part 1."} 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 (the losing residence state) in situations where that state is prevented from imposing tax under the treaty between the two residence states. On the other hand, if the losing residence state is entitled to impose tax on the income then the non-application of the treaty between that state and the source state can result in unrelieved double taxation. The losing residence state will generally only be entitled to impose tax in situations where the income is attributable to a PE of the dual resident located in that state. It is therefore proposed that dual residents should be excluded from claiming the benefit of treaties between their losing residence state and third states, but that treaty benefits be extended to PEs located in the losing residence state as outlined above. The next section deals with preventing the application of treaties between the losing residence state and third states, while the following section deals with the interaction between dual resident triangular cases and the extension of treaty benefits to PEs.

\subsection*{13.3.1. Preventing application of treaties between the losing residence state and third states}

The OECD Commentary expresses the view that a dual resident will not be resident in the losing residence state for the purposes of treaties concluded between that state and third states as a result of the application of the second sentence of Article 4(1).\footnote{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….."} This is based on the view that, as a result of the limitations contained in the treaty between the two residence states, the dual-resident will only be taxable in the losing residence state on income which is sourced in that state. This view is controversial, however, and given the lack of clarity in the application of the second sentence of Article 4(1), it does not seem appropriate deny treaty benefits on this basis. In light of the difficulties with the interpretation of the second sentence of Article 4(1), discussed in depth in Chapter 11, it is not a satisfactory way of dealing with (potentially improper) claims for treaty benefits by dual residents.

A better 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.\footnote{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. See: Avery Jones, J.F., & Bobbett, C., "Triangular Treaty Problems…"; 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. 45-48 (Chapter 3, Section 3.4).} Since residence for treaty purposes depends on residence for domestic law, this will have the effect that the dual resident will no longer be resident in that state (the losing residence state) for the purposes of treaties which that state has concluded with third states. This approach would be 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 and may also be relatively easy to implement since it does not require any renegotiation of tax treaties.

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. This limits states' incentive to develop and implement such a provision. It is also likely to have a significant impact on the application of other provisions of domestic law. In some cases this may be advantageous, since it may prevent dual residents who are resident in another state for treaty purposes from claiming certain benefits which would otherwise be available under domestic laws.\footnote{Sasseville, J., "A Tax Treaty Perspective…," at p. 47 (Chapter 3, Section 3.4.).} However, in other cases it may potentially give rise to
problems with the interaction between different provisions\textsuperscript{1417} or may result in the losing residence state unilaterally giving up taxing revenue. 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 for any state considering whether to implement such a provision.

A better approach would be to include a specific provision in tax treaties, which could deny 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 [i.e., Article 4], 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."

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. The main disadvantage is the extended period of time that it would take to implement, 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 the substantial period of time that can elapse before a treaty is renegotiated. This makes this approach less effective as a short-term solution. Nevertheless, this is considered to be the best approach for dealing with dual resident triangular cases.

\textbf{13.3.2. Interaction with extension of treaty benefits to PEs}

Under the treaty between the two residence states of a dual resident, the losing residence state would generally be entitled to impose tax on income arising in third states to the extent that it is attributable to a PE in that state. This situation is effectively the same as a PE triangular case and, 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 provides relief for tax imposed in the source state. If the treaty between the losing residence state and the source state 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 dual resident is not considered to be resident in the losing residence state for the purposes of that treaty, then the losing residence state would generally have no direct obligation to provide relief for tax imposed in the source state and thus, unrelieved double taxation may arise. This suggests that it would be preferable for the treaty between the losing residence state and the source state 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 extend treaty benefits to PEs as proposed for dealing with PE triangular cases. If treaty benefits were extended to PEs, then dual residents could be broadly denied treaty benefits under treaties between their losing residence state and third states, but treaty benefits would continue to be available to the extent that the income arising in third states is attributable to a PE in the losing residence state. Thus, improper access to the treaty between the losing residence state and the source state could be prevented (i.e., in situations where the losing residence state is prevented from imposing tax on the income) while still ensuring that unrelieved double taxation would not arise.

\textbf{13.4. Reverse PE triangular cases\textsuperscript{1418}}

In reverse PE triangular cases, both the residence state of the payor and the PE state may be entitled to impose source-based taxation on payments of interest (and potentially also royalties) under their respective treaties with the residence state of the person receiving the income. This dual source-based

\textsuperscript{1417} For example, Couzin identifies various issues that may arise in relation to the interaction between the Canadian Section 250(5) and other provisions of Canadian law (Couzin, R., \textit{Corporate Residence…}, at pp. 213-218 (Sections 4.2.3.3. and 4.2.3.4.)).

\textsuperscript{1418} Reverse triangular cases are discussed in Chapter 11.
taxation is problematic because it can lead to unrelieved double taxation if the residence state of the person receiving the income does not provide sufficient relief.\textsuperscript{1419} This risk of unrelieved double taxation can generally only be resolved by preventing one of the source states, preferably the residence state of the payor, from imposing tax on the interest.\textsuperscript{1420} This could be achieved by altering the wording of Article 11(5) to the effect that interest which originates from a PE would be considered to arise in the PE state even if the PE is located in a third state.\textsuperscript{1420} As a result, the interest would not be considered to arise in the payor's residence state for the purposes of applying the treaty between that state and the recipient's residence state (the HO-R treaty), and thus the distributive rule of Article 11 would not apply. Instead, Article 7 or Article 21 would apply and the payor's residence state would be prevented from imposing tax (assuming the recipient does not have a PE in that state). This could be achieved by adopting an alternative wording of Article 11(5) along the lines of that included in the OECD Commentary\textsuperscript{1421} as follows:

"Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a State other than that of which he is a resident, for the purposes of the treaty between the State of which he is resident and that other 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."

Any concerns that this may create opportunities for tax avoidance could be dealt with by limiting the circumstances in which the residence state would be prevented from imposing tax, e.g., such that the residence state would only be prevented from imposing tax if tax is imposed in the PE state.\textsuperscript{1422} The exact wording of the provision would ultimately depend on the situations in which the contracting states would be willing to give up their source-based taxing rights in relation to interest payments connected to a PE in a third state, which would in turn depend on their level of concern regarding the potential for interest income to escape source-based taxation.

\textbf{13.5. Reverse dual resident triangular cases\textsuperscript{1423}}

In reverse dual resident triangular cases, both residence states of the payor of passive income may be entitled to impose source-based taxation on the income under their respective treaties with the residence state of the person receiving the income.\textsuperscript{1424} This can result in unrelieved double taxation because the residence state of the recipient may not be in a position to provide sufficient relief.

Provided the residence of the dual resident payor is assigned to one state for the purposes of the treaty between the two residence states, the best approach would be to prevent the losing residence state from imposing tax on the payments (except where they originate from a PE located in that state). This could be achieved by a specific treaty provision preventing the dual-resident from being considered a resident of the losing residence state for the purposes of treaties which that state has concluded with third states.\textsuperscript{1425} Thus, the solutions to dual resident triangular cases discussed above (i.e., situations where income is received by a dual resident) would equally resolve the issues arising in reverse dual resident triangular cases. Briefly, it is proposed that a provision would be included 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

\textsuperscript{1419} For a discussion of situations where the residence state will and will not be able to provide sufficient relief for dual source-based taxation, refer to Chapter 3 (Section 3.2., which discusses relief in the residence state in PE triangular cases). In general, the residence state's ability to provide sufficient relief will depend on the effective rates of tax imposed in the source states relative to the effective rate of tax imposed in the residence state. Note that in reverse triangular cases, the relief in the PE state (discussed in Section 3.2.2.) will not be relevant.


\textsuperscript{1421} 2010 OECD Commentary on Article 11, para 30.

\textsuperscript{1422} Avery Jones, J.F., et al., "Tax Treaty Problems..."

\textsuperscript{1423} This section gives an overview of the discussion in Chapter 12, Section 12.3.

\textsuperscript{1424} Refer to the analysis of reverse dual resident triangular cases in Chapter 12, Section 12.3.

\textsuperscript{1425} Refer to the discussion in Chapter 12 (Section 12.3.5.).
otherwise be their residence state and the third state.\textsuperscript{1426} Suggested wording for the provision was mentioned above in relation to dual resident triangular cases and there would be no need to alter the wording of this provision to deal with reverse dual resident triangular cases, since it is the denial of residence itself that prevents the losing residence state from imposing source-based taxation.

Where the treaty between the two residence states is not effective in assigning residence to one state this approach is not practical, however, and a better approach would be to limit the residence states of the payor to imposing 50\% of the tax they would otherwise be entitled to impose on the income. This could be achieved by including specific wording in tax treaties as follows:

“Where dividends are paid to a resident of a Contracting State by a company which is resident in the other Contracting State and is also resident in a third State for the purposes of a convention between the last mentioned Contracting State and the third State, and is not deemed to be resident in only one of those States for the purposes of that convention, then the tax imposed in the Contracting State of which the payor is resident shall not exceed 50\% of the tax that may be imposed under [paragraph 2 of Article 10].”

Similar provisions could be included for interest and, if applicable, royalties (i.e., in situations where the treaty allows source-based taxation of royalties).

\textbf{13.6. General Conclusions}

Although each of the triangular cases discussed in this thesis is unique, there are many common threads and many of issues which they give rise to share the same underlying causes. Perhaps the clearest of these is the failure of bilateral tax treaties to take into account the effects of other bilateral treaties, whether that be an assignment of taxing rights under the distributive rules of the treaty or an allocation of residence under a residence tie-breaker provision. Nevertheless, it would not be sufficient to introduce some general principle requiring treaties to interact; in each case it is essential to specify exactly when and how a particular treaty should take into account the results of applying other treaties.

Problems also arise in triangular cases due to the overlap of the implicit sourcing rules in treaties. This is certainly the main issue in reverse triangular cases, but is also relevant in PE triangular cases where both the “source state” and the PE state are effectively seeking to impose source-based taxation. Clearly it is essential to resolve the overlap in the source rules in reverse PE triangular cases, but this is not the best approach for dealing with typical PE triangular cases since it would give rise to unavoidable risks of tax avoidance. Thus, again, the solution must be specific to the situation.

Finally, issues arise due to the hybrid nature of the PE concept; a source concept that has a lot in common with residence concepts and fulfils a very residence-like role in tax treaties. The problem here is not so much the residence-like nature and role of the PE concept, which is clearly very important for the proper operation of tax treaties, but that the implications of this have not been fully dealt with. For instance, the PE state is given the ability to impose tax on the worldwide income attributable to the PE, but with no corresponding direct obligation to provide relief. It is also not recognised for the purposes of determining the applicable treaty conditions in the source state. Again, these specific issues require a targeted solution.

In PE triangular cases the proposed solution is the extension of treaty benefits to PEs, treating the PE more like a resident enterprise and requiring both the source state and the PE state to apply the conditions of their treaty in relation to the income attributable to the PE. This ensures that unrelieved double taxation is prevented and that the source state applies the appropriate treaty conditions. Coupled with complementary provisions in the treaty between the residence state and the source state, it also ensures that that opportunities for improper use of that treaty are minimised.

In dual resident triangular cases and in reverse dual resident triangular cases, the solution is to make the allocation of residence under the treaty between the two residence states effective for the purposes of treaties which the residence states have each concluded with third states. This prevents a dual resident

\textsuperscript{1426} Refer to the discussion in Chapter 12 (Section 12.3.5.2.)
from claiming multiple treaty benefits with respect to the same income, and can prevent payments made by a dual resident from having a dual source. Finally, in reverse PE triangular cases, the proposed solution is to resolve the overlap in the sourcing rules for interest (and royalties) to ensure that such payments are not taxed on a source basis in more than one state.

These solutions can be achieved by including specific provisions in tax treaties, as outlined above and at the end of this chapter. The starting point for implementing these solutions would be to develop a multilateral consensus, recognising the issues involved and the desirability of resolving them, and gaining acceptance of the way in which triangular situations should be dealt with. This would ideally lead to amendment of the provisions of the OECD Model with the ultimate long-term aim of having specific provisions for dealing with triangular cases included in bilateral treaties. More broadly, and in the interim, drafters of treaty provisions should recognise more explicitly that not all situations covered by a particular treaty will be bilateral, and should be more willing to specifically deal with the possible interaction between the provisions of different tax treaties in relation to a single person or item of income.

13.7. Overview of proposed treaty provisions

13.7.1. PE triangular cases – extension of treaty benefits to PEs:

The most comprehensive way of dealing with PE triangular cases would be to extend treaty benefits to PEs. This would ensure both that the PE state provides relief for tax imposed in the source state (thus preventing unrelieved double taxation) and that the source state applies the more appropriate treaty conditions, i.e., those contained in the treaty between the source state and the PE state. The following table includes an overview of suggested treaty provisions for extending treaty benefits to PEs and for supplementary provisions excluding the application of the treaty between the residence state and the source state.

<table>
<thead>
<tr>
<th>Aim of the provision</th>
<th>Suggested text</th>
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</table>
| Preventing application of the R-S treaty:                                            | "(1) Where an enterprise of a Contracting State derives income from the other Contracting State, and that income is attributable to a permanent establishment which that enterprise has in a third state for the purposes of a convention between the Contracting State of the enterprise and that third state, the tax benefits which would otherwise be available under the other provisions of this Convention will not apply to that income if the profits of the permanent establishment are subject to a combined aggregate effective rate of tax in the first-mentioned Contracting State and third state that is less than [60] percent of the general company tax rate applicable in the first-mentioned Contracting State. Any dividends, interest or royalties to which the provisions of this paragraph apply shall be subject to tax in the other Contracting State at a rate that shall not exceed [15] percent of the gross amount thereof. Any other income to which the provisions of this paragraph apply shall be subject to tax under the provisions of the domestic law of the other Contracting State, notwithstanding any other provision of the Convention. The provisions of this paragraph shall not apply if:

a) In the case of royalties, the royalties are received as compensation for the use of, or the right to use, intangible property produced or developed by the permanent establishment itself; or

b) In the case of any other income, the income derived from the other Contracting State is derived in connection with or is incidental to, the active conduct of a business carried on by the permanent establishment in the third state (other than the business of making, managing or simply holding investments for the enterprise's own account).

(2) Where an enterprise of a Contracting State derives income from the
other Contracting State, and that income is attributable to a permanent establishment which that enterprise has in a third state for the purposes of a convention between the Contracting State of the enterprise and that third state, the tax benefits which would otherwise be available under the other provisions of this Convention will not apply to that income if the other Contracting State applies the conditions of a convention between that State and the third state in relation to that income.

(3) This article shall apply to capital gains and profits in the same way as it applies to income.

(4) Where the tax benefits which would otherwise be available under the other provisions of this Convention do not apply as a result of paragraph 1 or paragraph 2, the Contracting State where the person deriving the income is resident shall continue to apply [Article 23A/ Article 23B]. However, that State shall not apply [Article 23A/Article 23B] if the other Contracting State is prevented from imposing tax on the income under the terms of a convention with a third state. Where a Contracting State applies [Article 23A / Article 23B] under this paragraph, it shall be applied as though the other Contracting State has applied the other provisions of this Convention in relation to the income.

<table>
<thead>
<tr>
<th>Ensuring the residence state continues to have a relief obligation:</th>
</tr>
</thead>
<tbody>
<tr>
<td>To ensure that the residence state continues to provide relief for tax imposed in the source state where necessary.</td>
</tr>
</tbody>
</table>

"(3) Where the tax benefits which would otherwise be available under the other provisions of this Convention do not apply as a result of paragraph 1 or paragraph 2, the Contracting State where the person deriving the income is resident shall continue to apply [Article 23A/ Article 23B]. However, that State shall not apply [Article 23A/Article 23B] if the other Contracting State is prevented from imposing tax on the income under the terms of a convention with a third state. Where a Contracting State applies [Article 23A / Article 23B] under this paragraph, it shall be applied as though the other Contracting State has applied the other provisions of this Convention in relation to the income."

<table>
<thead>
<tr>
<th>Extending treaty benefits to PEs:</th>
</tr>
</thead>
<tbody>
<tr>
<td>To require both the source state and the PE state to apply the conditions of the PE-S treaty in relation to income arising in the source state and attributable to the PE.</td>
</tr>
</tbody>
</table>

Paragraph 1(a) of this provision applies where the enterprise to whom the PE belongs is resident in a state which has concluded a treaty with the PE state. Paragraphs 1(b) and 1(c), on the other hand, apply in cases where the enterprise is not resident in a state which has a treaty with the PE state, in keeping with the view that the residence state of the enterprise is not relevant to the extension of treaty benefits to the PE.

Paragraph 2 ensures that treaty benefits are also available with respect to profits and capital gains attributable to the PE.

"(1) For the purposes of this Convention, notwithstanding the provisions of Article 1 (Persons Covered),

(a) where a person, who is not a resident of either of the Contracting States, has a permanent establishment in one of the Contracting States for the purposes of a convention between Contracting State where the permanent establishment is located and a third state, then this Convention shall apply to any income included in the profit attributable to the permanent establishment (for the purposes of the convention between the Contracting State where the permanent establishment is located and the state where the person is resident) as though that income were income of a resident of the Contracting State in which the permanent establishment is located. However, this Convention shall not apply to income which the Contracting State where the permanent establishment is located is prevented from taxing under the convention between that State and the person's residence state or between that State and a third state.

(b) where a person who is not a resident of either of the Contracting states, carries on business in State A through a [permanent establishment] (as defined under the laws of State A) and that person is not considered a resident of a third state for the purposes of a convention between State A and that third state, then this Convention shall apply to any income included in the profit attributable to the [permanent establishment] (under the domestic law of State A) as though that income were income of a
Paragraph 3 ensures that the various articles of the OECD Model will apply regardless of the terms used to establish their application and that the income is considered to be beneficially owned by a resident of the PE state.

See Chapter 8 (Section 8.2.) for discussion.

Preventing improper claims for treaty benefits by PEs:

Examples of provisions which could be included in tax treaties to prevent improper claims for treaty benefits by PEs, along with examples of safe harbour provisions to prevent the unreasonable denial of benefits.

See Chapter 8 (Section 8.4.) for discussion.

Subject to tax provision: "Where this Conventions applies under this article to income arising in a Contracting State and included in the income attributable to a permanent establishment located in the other Contracting State, any provision of this convention conferring an exemption from, or a reduction of, tax shall apply only to income that is subject to tax in the last-mentioned State which is equivalent to the tax that would be imposed in that state if the income were derived by a resident of that State in the same circumstances as the permanent establishment."

Anti-base erosion provision: "Where income arising in a Contracting State is included in the income attributable to a permanent establishment located in the other Contracting State to which the Convention applies under this Article, any provision of this Convention conferring an exemption from, or a reduction of, tax shall not apply if more than 50 per cent of the gross income attributable to the PE is paid or accrued to persons who are not resident in either of the contracting states in the form of payments that are deductible, including notional payments to other parts of the enterprise to which the PE belongs, but excluding arm's length payments in the ordinary course of business for services or tangible property."

Denial of treaty benefits where there is a tax avoidance motive: "The provisions of this Convention shall not apply under this Article in relation to any item of income if it was the main purpose or one of the main purposes of any person concerned with the creation of the permanent establishment or any actions which cause that income to be included in the profit attributable to the permanent establishment to take advantage of this Article by means of that creation or attribution."

Safe harbour provisions:

General bona-fides provision: "The provision of this Convention shall not apply under this Article where the person to which the permanent establishment belongs establishes that the principal purpose of the permanent establishment, the conduct of its business and, if applicable, that the acquisition or maintenance by it of property from which the income in question is derived, are motivated by sound business reasons and do not have as a primary purpose the obtaining of any benefits under..."


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13.7.2. PE triangular cases – the minimalist approach:

The "minimalist approach" to resolving PE triangular cases would achieve two aims; it would prevent improper access to the treaty between the residence state and the source state and it would prevent unrelieved double taxation by requiring the PE state to provide relief for tax imposed in the source state. It does not, however, require the source state to apply the conditions of its treaty with the PE state, and does not require the PE state to grant relief under its treaty with the source state (the obligation instead arises under the treaty between the residence state and the PE state). The following table contains an overview of the provisions which could be included in bilateral tax treaties to implement the minimalist approach for dealing with PE triangular cases.

<table>
<thead>
<tr>
<th>Aim of the provision</th>
<th>Suggested text</th>
</tr>
</thead>
</table>
| **Relief in the PE state:** | "(1) When an enterprise of a Contracting State receives income which is included in the profit attributable to a permanent establishment in the other Contracting State and that income may be taxed in a third state under an applicable tax treaty between the first-mentioned Contracting State and that third state, the state where the permanent establishment is located shall grant relief in respect of the tax paid on the income in the third state, provided such relief would be available if the income were derived by an enterprise of the Contracting State where the permanent establishment is located.

(2) If there is a convention between the Contracting State where the permanent establishment is located and the third state, the Contracting State where the permanent establishment is located shall apply the article of that convention which provides for the elimination of double taxation as though the permanent establishment were a resident of the State where it is located for the purposes of that convention. The Contracting State where the permanent establishment is located may apply that provision as though that..." |
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1427 The paragraphs denying treaty benefits. This provision is worded on the basis that it would be included in the article of the treaty which extends treaty benefits to PEs, and which includes the specific provisions denying treaty benefits in certain cases.

1428 The paragraphs denying treaty benefits. This provision is worded on the basis that it would be included in the article of the treaty which extends treaty benefits to PEs, and which includes the specific provisions denying treaty benefits in certain cases.

1429 The paragraphs denying treaty benefits. This provision is worded on the basis that it would be included in the article of the treaty which extends treaty benefits to PEs, and which includes the specific provisions denying treaty benefits in certain cases.
The convention had also been applied in the third state to the income attributable to the permanent establishment as though the permanent establishment were a resident of the State where it is located and, where relevant, taking into account any limitation on the amount of tax imposed in the third state under any applicable convention between the Contracting State of the enterprise and that third state.

(3) If the Contracting State where the permanent establishment is located grants relief other than under paragraph 2, the relief shall be granted under the same conditions, including with respect to the method of relief, that would apply if the income were derived by an enterprise of that State."

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**Preventing improper access to the R-S treaty:**

To prevent a person from claiming reductions in source-based taxation under the R-S treaty in relation to income attributable to a PE in a third state in situations which the contracting states consider to be improper.

The suggested text is based on the wording of provisions included in many US treaties.

See Chapter 7 (Section 7.5.1.) for discussion.

"(1) Where an enterprise of a Contracting State derives income from the other Contracting State, and that income is attributable to a permanent establishment which that enterprise has in a third state for the purposes of a convention between the Contracting State of the enterprise and that third state, the tax benefits which would otherwise be available under the other provisions of this Convention will not apply to that income if the profits of the permanent establishment are subject to a combined aggregate effective rate of tax in the first-mentioned Contracting State and third state that is less than [60] percent of the general company tax rate applicable in the first-mentioned Contracting State. Any dividends, interest or royalties to which the provisions of this paragraph apply shall be subject to tax in the other Contracting State at a rate that shall not exceed [15] percent of the gross amount thereof. Any other income to which the provisions of this paragraph apply shall be subject to tax under the provisions of the domestic law of the other Contracting State, notwithstanding any other provision of the Convention. The provisions of this paragraph shall not apply if:

a) In the case of royalties, the royalties are received as compensation for the use of, or the right to use, intangible property produced or developed by the permanent establishment itself; or

b) In the case of any other income, the income derived from the other Contracting State is derived in connection with or is incidental to, the active conduct of a business carried on by the permanent establishment in the third state (other than the business of making, managing or simply holding investments for the enterprise’s own account).

(2) This article shall apply to capital gains and profits in the same way as it applies to income."

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### 13.7.3. Dual resident and reverse triangular cases

The following is an overview of the provisions which could be included in bilateral tax treaties to deal with dual-resident triangular cases and reverse triangular cases.

<table>
<thead>
<tr>
<th>Aim of the provision</th>
<th>Suggested text</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dual-resident triangular cases and reverse dual-resident triangular cases:</strong></td>
<td>&quot;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.&quot;</td>
</tr>
</tbody>
</table>
OECD Model).
See Chapter 11 (Section 11.3.2.) and Chapter 12 (Section 12.3.5.2.) for discussion.
Note: this could also be achieved by incorporating the result of the tie-breaker into domestic law. See Chapter 11 (Section 11.3.1.) for discussion.

<table>
<thead>
<tr>
<th>Reverse dual resident triangular cases where there is no effective allocation of residence</th>
</tr>
</thead>
<tbody>
<tr>
<td>To limit the tax imposed in the residence states of the dual resident payor to 50% of the tax that they would otherwise be entitled to impose in situations where the tie-breaker provision of the treaty between the two residence states does not assign residence to one state.</td>
</tr>
<tr>
<td>This provision refers to dividends (and is designed to be included in Article 10) but similar provisions should be included in the treaty to deal with interest (Article 11) and, if applicable, royalties (Article 12).</td>
</tr>
<tr>
<td>See Chapter 11 (Section 11.3.2.) for discussion.</td>
</tr>
</tbody>
</table>

“Where dividends are paid to a resident of a Contracting State by a company which is resident in the other Contracting State and is also resident in a third State for the purposes of a convention between the last mentioned Contracting State and the third State, and is not deemed to be resident in only one of those States for the purposes of that convention, then the tax imposed in the Contracting State of which the payor is resident shall not exceed 50% of the tax that may be imposed under [paragraph 2 of Article 10].”

<table>
<thead>
<tr>
<th>Reverse PE triangular cases:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alternative Article 11(5) (differences to the current wording are in italics) to prevent the residence state from imposing source-based taxation on income which is connected with a PE of the payor located in a third state, except where the PE state does not impose any source-based tax on the income. This provision could also outline other situations in which the interest would continue to arise in the residence state, and thus in which the residence state would continue to be entitled to impose tax.</td>
</tr>
<tr>
<td>See Chapter 12 (Section 12.2.2.) for discussion.</td>
</tr>
</tbody>
</table>

“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 State other than that of which he is a resident, for the purposes of the treaty between the State of which he is resident and that other 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.”