Triangular cases: The application of bilateral tax treaties in multilateral situations
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Section II: PE triangular cases combined with reverse dual resident triangular cases

2.1. Introduction

The situation discussed in this section is a combination of a typical PE triangular case\(^{1502}\) and a reverse dual resident triangular case\(^{1503}\). It involves a person who is resident in one state ("State R") and has a PE in a second state ("State PE") who derives income from outside those two states which is attributable to the PE. The income is paid by a person who is resident in two (other) states for both domestic law and treaty purposes, i.e., a dual resident. The tie-breaker provision of the treaty between the payor’s residence states assigns the dual resident person’s residence to one state for the purposes of that treaty; the state to which residence is assigned is referred to as the winning residence state ("State W") and the other state is referred to as the losing residence state ("State L"). State W and State L are referred to collectively as the “source states.” Finally, it is assumed that the payor does not have a PE in the losing residence state or that if it does, the payment is not connected with and does not originate from that PE. This situation is illustrated in the following diagram (in which “HO” denotes head office):

![Diagram showing the relationship between State R, State PE, State W, and State L.]

2.1.1. The existing treaty framework

Under the existing treaty framework, the applicable treaties in this case will be:

(i) the treaty between the residence state of the recipient and the winning residence state of the payor (the R-W treaty);

(ii) the treaty between the residence state of the recipient and the losing residence state of the payor (the R-L treaty); and

(iii) the treaty between the residence state of the recipient and the PE state of the recipient (the R-PE treaty).

The treaty between the two residence states of the payor will apply to determine the taxation that those two states may impose on the income derived by the dual resident. It will not apply, however, in relation to income paid by the dual-resident person to a person resident in a third state. The treaties between the recipient’s PE state and the source states (the PE-W treaty and the PE-L treaty) will not apply because, for the purposes of both of these treaties, the income is not received by a resident of one of the contracting states.

For the purposes of the analysis in this appendix, it is assumed that the allocation of residence under the tie-breaker provision of the treaty between the two residence states of the payor has no effect on the application of treaties concluded between State L and third states. That is, residence must be determined independently for each treaty. This means that any amount paid by the dual resident will continue to be considered to be paid by a resident of State L for the purposes of treaties between that state and third states. This assumption is not free from doubt; for further discussion of the application of treaties between the losing residence state and third states, please refer to Chapter 11.\(^{1504}\)

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\(^{1502}\) For a detailed overview of the application of tax treaties in typical PE triangular cases, refer to Chapter 2.

\(^{1503}\) For a detailed discussion of reverse dual resident triangular cases, refer to Chapter 12 (Section 12.3.).

\(^{1504}\) Chapter 11 deals with the application of treaties between the losing residence state and third states in dual resident triangular cases, but is equally relevant in reverse dual resident triangular cases. The OECD Commentary takes the position that a dual resident will not be considered a resident of the losing residence state for the purposes of treaties concluded between that state as a result of the second sentence of Article 4(1). The second sentence of
The outcome in this case will depend upon the category of income involved and the extent to which source-based taxation is allowed in the absence of a PE. In situations involving dividends and interest (and potentially royalties), where source based taxation is allowed in the residence state of the payor, tax may potentially be imposed in all four states. That is, both the source states may impose tax based on the residence of the payor, the PE state may impose tax on the basis of the profit attributable to the PE, and the residence state may impose tax on the basis of the residence of the person receiving the income. In the case of income from immovable property, the outcome in this case is effectively the same as the outcome in a typical PE triangular case; State W and State L are both prevented from imposing any tax on the income except to the extent that the property is located in one of those states, and thus, the dual-resident nature of the payor does not have any impact on the outcome. For those categories of income where no source-based taxation is allowed unless the income is attributable to a local PE of the recipient (such as income from shipping and air transport and other income, as well as some types of capital gains), there will be no taxation in either of the source states. Overall, the outcome in this situation will generally be the same as the outcome of a typical PE triangular case, with the exception of cases involving dividends and interest (and potentially royalties) where both source states may impose tax in addition to the tax imposed in the PE state and the residence state of the person deriving the income. This additional layer of taxation means that unrelieved double taxation is more likely to occur and that where it does occur, the quantum of unrelieved double taxation is likely to be greater.

2.1.2. Application of proposed solutions

The relevant proposals for the situation discussed in this section are those which are aimed at dealing with typical PE triangular cases and reverse dual-resident triangular cases.

Application of treaties between the PE state and third states

It is proposed that where a resident of one state derives income which is attributable to a PE in a second state (for the purposes of the treaty between those two states), the person deriving the income should be entitled to claim the benefits of treaties concluded between the PE state and third states in relation to the income attributable to the PE. As a result, the state where the income arises (the source state) would be obliged to apply the conditions of its treaty with the PE state, and the PE state would be obliged to grant relief in accordance with the terms of that treaty. The proposed treaty provision is 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.

…

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 treaties concluded between their losing residence state and third states as a result of the restrictions imposed on the losing residence state’s taxing rights under the treaty between the two residence states. This position is controversial, however, and is discussed in detail in Chapter 11 (Section 11.2.).

1505 This proposal is discussed in detail throughout Chapter 7 and Chapter 8.
(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 the preceding paragraphs 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 establishment … is located for the purposes of the application of this Convention under those paragraphs.1506

Note that paragraphs 1(b) and 1(c) of this proposed provision (which are not reproduced above) are intended to deal with situations where treaties do not exist between all the contracting states. They are thus not relevant for the analysis conducted in this appendix, since it is assumed that there are treaties in place between all the states involved.

In the situation discussed in this section, the application of this proposed provision would mean that the person deriving the income would be entitled to claim the benefit of the treaties concluded between State PE1 and the source states (State W and State L). The exclusion for situations where the PE state of the recipient of the income is prevented from imposing tax will also be relevant in some cases.

Limited application of treaties between the residence state and third states1507

It is proposed that in PE triangular cases, the application of tax treaties between the residence state of the person deriving the income and third states where income arises (source states) be restricted. It is proposed that a source state will not be required to apply the conditions of its treaty with the residence state in relation to income attributable to a PE in a third state if either:

5. The source state applies the conditions its treaty with the PE state in relation to that income; or

6. The source state does not apply the conditions of its treaty with the PE state, but the situation is one where the application of the conditions of the treaty with the residence state would be considered improper (in accordance with certain specified criteria).

The proposed provision is as follows:

"(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 the 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)."

1506 This provision is extracted from Chapter 8 (see Section 8.2.5.).
1507 This aspect of the proposed solutions is discussed in depth in Chapter 7 (see in particular Section 7.5.).
(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) 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(2) / 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."

In the situation discussed in this section, the effect of this provision would be to exclude the operation of the treaties between the residence state (State R) and the two source states (State W and State L). However, these treaties will continue to require State R to provide relief (under paragraph 3 of the provision set out above). In accordance with the wording of this provision, no relief would be required in State R to the extent that the source states are prevented from imposing tax under their respective treaties with State PE. Furthermore, where State R uses the credit method of relief (either under Article 23A(2) or under Article 23B), the credit in State R is specifically limited to the rate of tax that the source state could have imposed if it applied the terms of its treaty with State R.

Making the allocation of residence effective for the purposes of treaties with third states

It is proposed that dual-resident persons be specifically excluded from being resident in their losing residence state for the purposes of treaties between that state and third states. This would essentially make the allocation of residence under the treaty between the two residence states of a dual resident person effective for the purposes of other tax treaties. It is proposed that this be achieved by including a specific provision in tax treaties, which could be worded along the following lines (for inclusion in Article 4, i.e., the residence article):

"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."

In the case of a dual-resident making payments of passive income to residents of a third state, this would mean that the dividends, interest or royalties would be paid by a person who is not resident of the losing residence state for the purposes of the treaty between that state and the state where the person receiving the income is resident (i.e., the R-L treaty). As a result, and as will be seen below, State L would be prevented from imposing source-based taxation.

Applicable treaties

If these proposed provisions are incorporated into all the relevant treaties, the applicable treaties in the situation discussed in this section would be:

(i) the treaty between the residence state of the recipient and the winning residence state of the payor (the R-W treaty) – State W will not be bound by the conditions of this treaty, but State R may have a relief obligation;

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1508 This provision is extracted from Chapter 7 (Section 7.5.4.) where it is discussed in much greater depth.
1509 This proposal is discussed in detail in Chapter 11 (Section 11.3.2.) and, in the context of reverse dual resident triangular cases, in Chapter 12 (Section 12.3.5.).
1510 This proposed provision is extracted from Chapter 11 (Section 11.3.2.) where it is discussed in-depth.
(ii) the treaty between the PE state of the recipient of the income and the winning residence state of the payor of the income (the PE-W treaty) – State W will be obliged to apply the conditions of this treaty in relation to the income attributable to the PE and State PE may be obliged to provide relief;

(iii) the treaty between the residence state of the recipient and the losing residence state of the payor (the R-L treaty) – State L will not be bound by the conditions of this treaty, but State R may have a relief obligation;

(iv) the treaty between the PE state of the recipient of the income and losing residence state of the payor (the PE-L treaty) – State L must apply the conditions of this treaty in relation to the income attributable to the PE and State PE may be obliged to provide relief; and

(v) the treaty between the recipient's residence state and recipient's PE state (the R-PE treaty) – this treaty will apply in same way as it applies under the existing treaty framework.

The only treaty which will not apply in this situation is the treaty between the two residence states of the payor of the income (the W-L treaty), since the income is not derived by a resident of either of these two states. This treaty will apply, however, to determine the taxation that those two states may impose on the income derived by the dual resident.

The following sections will discuss the application of tax treaties in this situation where different categories of income are involved, firstly under the existing framework and secondly where the relevant treaties include the proposed provisions outlined above.

2.2. Business profits

Article 7 deals with business profits and allows the residence state of the person deriving the income to impose tax. It also allows the other contracting state to impose tax, but only in relation to profits which are attributable to a PE in that other state.\textsuperscript{1511} Article 7 (in paragraphs 1 and 2) provides as follows:

“1. Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.

2. For the purposes of this Article and Article [23 A] [23B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.”\textsuperscript{1512}

Thus, the source state may not impose any tax on business profits except to the extent they are attributable to a PE. For further discussion of the PE concept and the attribution of profit to PEs, refer to the discussion in Chapter 5 (Sections 5.2.3. and 5.2.4.).

This section deals with a situation where a person resident in State R derives income which is attributable to a PE in State PE. The income is paid by a dual-resident, a person who is resident in both State W and State L for treaty purposes. It is assumed that the payor's residence is assigned to State W for the purposes of the W-L treaty. This situation is illustrated in the following diagram (in which “HO” denotes head office):

\textsuperscript{1511} The term “permanent establishment” is defined in Article 5.

\textsuperscript{1512} Article 7, paragraphs 1 and 2.
For a more detailed discussion of PE triangular cases involving business profits, refer to Chapter 2 (Section 2.4.). For more detailed discussion of reverse dual resident triangular cases, including a brief overview of the outcome in reverse dual-resident triangular cases involving business profits, refer to Chapter 12 (Section 12.3.).

2.2.1. Existing treaty framework

The winning residence state of the payor (State W): State W must apply the conditions of the R-W treaty. For the purposes of that treaty, Article 7 will apply and, given that the income is not attributable to a PE in State W, State W will be prevented from imposing tax.

The losing residence state of the payor (State L): State L must apply the conditions of the R-L treaty. For the purposes of that treaty, Article 7 will apply and, given that the income is not attributable to a PE in State L, State L will be prevented from imposing tax on the income.

The recipient’s PE state (State PE): State PE must apply the conditions of the R-PE treaty. For the purposes of that treaty, Article 7 will apply and State PE will be entitled to impose tax on the profit attributable to the PE.

The recipient’s residence state (State R): State R must apply the conditions of the R-W treaty, the R-L treaty and the R-PE treaty. None of those treaties will restrict State R’s ability to impose tax on the income, however State R will be obliged to provide relief (either exemption or credit) under the R-PE treaty.

Overview: Under the existing treaty framework, tax may only be imposed in State R and State PE, and State R will be obliged to provide relief. There will be no unrelieved double taxation. This situation is effectively the same as a typical PE triangular case involving business profits, since both source states are prevented from imposing tax, and gives rise to the same issue; namely, the application of the “wrong” treaty conditions in the source states (State W and State L).1513

2.2.2. Application of proposed solutions

The winning residence state of the payor (State W): Instead of being bound by the conditions of the R-W treaty, State W must now apply the conditions of the PE-W treaty. In relation to business profits, Article 7 applies and given that the income is not attributable to a PE in State W, State W would be prevented from imposing tax on the income. This outcome is the same as where the R-W treaty applies. The outcome may differ, however, if the PE definitions differ between the two treaties. For example, if the PE threshold is lower in the PE-W treaty than in the R-W treaty, then a PE may exist for the purposes of the first treaty but not the second. Nevertheless, in most cases the application of the L-W treaty instead of the R-W treaty will have no impact on State W’s ability to impose tax on the income.

The losing residence state of the payor (State L): Instead of being bound by the conditions of the R-L treaty, State L must now apply the conditions of the PE-L treaty. In relation to business profits, Article 7 applies and given that the income is not attributable to a PE in State L, State L would be prevented from imposing tax. The application of the treaty with the PE state instead of the treaty with the residence state

1513 That is, the source states apply the conditions of their treaties with the residence state of the recipient of the income (State R1) rather than the conditions of their treaties with the PE state (State PE1), despite the allocation of primary (or even exclusive) taxing rights to State PE1 under the R1-PE1 treaty. The reasons for considering this the “wrong” treaty are discussed in depth in Chapter 6.
will generally have no impact in State L in relation to business profits, however, it may have an impact if the PE definitions differ between the two treaties.

**The recipient’s PE state (State PE):** State PE must continue to apply the conditions of the R-PE treaty. For the purposes of this treaty, Article 7 will apply and State PE will be entitled to impose tax on the profit attributable to the PE. State PE is also obliged to apply the conditions of its treaties with State W and State L, in particular the relief provisions. In relation to business profits, however, both of the source states are prevented from imposing tax and State PE therefore has no relief obligation.

**The recipient’s residence state (State R):** State R must continue to apply the R-W treaty, the R-L treaty and the R-PE treaty. There is no restriction on State R’s ability to impose tax on the income, however, State R does have an obligation to provide relief (either exemption or credit) under the R-PE treaty. State R does not have any obligation to provide relief under either the R-W treaty or the R-L treaty, since both State W and State L are prevented from imposing tax under their respective treaties with State PE.

**Overview:** The proposed solutions would generally have little practical impact in this situation, since the distributive rules for business profits do not usually differ between treaties. Furthermore, because no tax can be imposed in the source states, no relief is required in the recipient’s PE state. One situation where a different outcome may arise is where the PE definition contained in a source state’s treaty with State R differs from that contained in its treaty with State PE. Where this occurs, the source state may be entitled to impose tax if it applies the conditions of its treaty with State R but not if it applies the conditions of its treaty with State PE or vice versa. In order for this to fit within the scenario discussed in this section, however, the PE in the source state would have to be a sub-PE of the PE in State PE (sub-PE triangular cases are discussed in Chapter 2 (Section 2.4.1.) and in Chapter 8 (Section 8.6.6.). In addition, the residence of the payor has no impact on the distribution of taxing rights with respect to income dealt with under Article 7 and, as a result, the fact that the dual-resident payor is no longer considered to be resident in State L for the purposes of the R-L treaty will have no impact on the outcome in this case.

### 2.3. Dividends

Dividends are dealt with in Article 10. Article 10 allows the state where the payor of dividends is resident (the source state) to impose tax, but limits the amount of the tax to a certain percentage of the gross amount of the dividends. Article 10 provides as follows (in paragraphs 1 and 2):

> “1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

> 2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

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

> b) 15 per cent of the gross amount of the dividends in all other cases.”

Thus, the rate of tax that may be imposed in the source state depends on recipient’s interest in the company paying the dividends.\(^{1514}\) The exact rates are a common point of negotiation, however, and often vary between treaties. The ownership thresholds also vary in many concluded treaties and some treaties may provide only a single maximum tax rate. Furthermore, if the dividends are attributable to a PE of the recipient which is located in the source state, then as a result of Article 10(3), Article 7 will apply instead of Article 10 and the source state may impose tax on the basis of the profit attributable to the PE.

\(^{1514}\) The application of this threshold (and other treaty thresholds) in situations where treaty benefits are claimed in relation to the income attributable to a PE are discussed in Chapter 8 (Section 8.6.2.).
This section deals with a situation where a person resident in State R receives dividends which are attributable to a PE located in State PE. The dividends are paid by a dual-resident, a person who is resident in two states (State W and State L) for treaty purposes. The payor’s residence is assigned to State W for the purposes of the W-L treaty. This situation is illustrated in the following diagram (in which “HO” denotes head office):

For a detailed discussion of PE triangular cases involving dividends, refer to Chapter 2 (Section 2.5.1.). For a detailed discussion of reverse dual resident triangular cases involving dividends, refer to Chapter 12 (Section 12.3. and in particular, Section 12.3.4.).

2.3.1. Existing treaty framework

*The winning residence state of the payor (State W):* State W must apply the conditions of the R-W treaty. For the purposes of this treaty, the dividends are paid by a resident of State W. Article 10 will therefore apply and State W will be entitled to impose a limited rate of tax on the dividends.

*The losing residence state of the payor (State L):* State L must apply the conditions of the R-L treaty. For the purposes of this treaty, the dividends are paid by a resident of State L. Article 10 will therefore apply and State L will be entitled to impose a limited rate of tax on the dividends. State L may be prevented from imposing tax, however, under Article 10(5) of the W-L treaty.1515

*The recipient’s PE state (State PE):* State PE must apply the conditions of the R-PE treaty. The dividends are attributable to a PE in State PE and therefore, as a result of Article 10(3), will fall under the distributive rule of Article 7 of the purpose of this treaty. Under Article 7, State PE will be entitled to impose tax on the profit attributable to the PE. State PE may also have an obligation to provide relief for the tax imposed in State W and State L under the PE non-discrimination provision (Article 24(3)) of its treaty with State R, however, the scope of this obligation is not completely clear.1516

*The recipient’s residence state (State R):* State R must apply the conditions of the R-W treaty, the R-L treaty and the R-PE treaty. State R may impose tax but will be obliged to provide relief under the R-W treaty.

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1515 Article 10(5) provides that: "Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment situated in that other State, nor subject the company’s undistributed profits to a tax on the company’s undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.” Thus, this provision should prevent the losing residence state from imposing tax on the dividends. The main problem with applying this provision is that it applies under the treaty between the two residence states of the payor and, for the purposes of this treaty, the recipient of the dividends is not a resident of either of the contracting states. In addition, it may apply only where the company derives profits or income from the state seeking to impose tax on the dividends. Article 10(5) is discussed in detail in Chapter 12 (see Section 12.2.1. and Section 12.3.4.).

1516 The PE state’s potential relief obligation under Article 24(3) is discussed in depth in Chapter 4. Article 24(3) requires that the tax imposed on the PE in the PE state be “not less favorably levied” than the tax imposed on a resident enterprise carrying on the same activities. It is quite clear that this requires the PE state to extend the benefit of any domestic relief provisions to the PE. It is less clear however, whether this also requires the PE state to extend to the PE any relief that would be available to local residents under the PE-S treaty. For detailed discussion of these issues, please refer to Chapter 4 (particularly Section 4.3.).
(using the credit method, regardless of the general relief method specified in the treaty\textsuperscript{1517}) and the R-PE treaty (using either the credit or exemption method). If State L is not prevented from imposing tax under Article 10(5) of the W-L treaty, State R will also be obliged to provide relief (using the credit method) for tax imposed in State L. Where State R provides relief using the exemption method under the R-PE treaty, it should not be obliged to grant any additional credit relief under the R-W treaty (or the R-L treaty)\textsuperscript{1518}

\textit{Overview:} In this situation, tax may be imposed in State W, State L, State PE and State R. State R will have an obligation to provide relief under its treaties with State W, State L and State PE, and State PE may also have an obligation to provide relief for tax imposed in State W and State L (under Article 24(3) of the R-L treaty). In this situation, there is both dual source-based taxation as a result of the dividends being paid by a dual resident, and tax imposed in both State PE and State R. Given that tax is imposed in four separate states, it is highly likely that there will be unrelieved double taxation despite the relief provided in State R, even if relief is also provided in State PE. In this situation the source states (State W and State L) are also applying the "wrong" treaty conditions.\textsuperscript{1519}

2.3.2. Application of proposed solutions

\textit{The winning residence state of the payor (State W):} Instead of being bound by the conditions of the R-W treaty, State W must now apply the conditions of the PE-W treaty in relation to the income attributable to the PE in State PE. For the purposes of the PE-W treaty, the dividends are paid by a resident of State W and Article 10 applies. Under Article 10, State W may impose a limited rate of tax on the dividends. This rate may differ from that specified in the R-W treaty.

\textit{The losing residence state of the payor (State L):} Instead of being bound by the conditions of the R-L treaty, State L must now apply the conditions of the PE-L treaty in relation to the income attributable to the PE in State PE. For the purposes of applying this treaty, however, the payor of the dividends will no longer be considered to be resident in State L and, as a result, Article 10 will not apply. Instead, if the dividends are considered to be business profits, Article 7 will apply. If the dividends are not considered to be business profits, then Article 21 will apply. Regardless of whether Article 7 or Article 21 applies, however, State L will be prevented from imposing tax. If State L is prevented from imposing tax as a result of Article 10(5) of the W-L treaty under the existing treaty framework, then the outcome in this case will not be any different (and Article 10(5) may also continue to prevent State L from imposing tax). However, there is some uncertainty regarding the application of Article 10(5) in this situation and preventing State L from imposing tax under the terms of the PE-L treaty makes the outcome clearer and more certain.

\textit{The recipient's PE state (State PE):} State PE must continue to apply the R-PE treaty. For the purposes of this treaty, Article 7 applies and State PE may impose tax on the profit attributable to the PE. State PE must also apply the conditions of the PE-W treaty and the PE-L treaty. State PE is obliged to provide relief for tax imposed in State W under the relief provisions of the PE-W treaty; given that dividends are involved this would typically be credit relief regardless of the general method of relief specified in the treaty.

\textsuperscript{1517} Where the treaty provides for the exemption method of relief under Article 23A, paragraph 2 nevertheless requires the residence state to grant relief using the credit method for income which may be taxed in the other contracting state under Article 10 (or Article 11).

\textsuperscript{1518} This was discussed in Chapter 3 (Section 3.3.), where it was concluded that the exemption under one treaty should be taken into account when determining the amount of tax imposed in the residence state in respect of the income for the purposes of applying the relief provisions of the treaty requiring credit relief. As a result, there will be no tax imposed on the income in the residence state for the purposes of that provision and no credit will be required (in accordance with the terms of Article 23A(2) or Article 23B, as applicable). Please see Chapter 3 for an in-depth discussion of this issue.

\textsuperscript{1519} That is, the source states apply the conditions of their treaties with the residence state of the recipient of the income (State R) rather than the conditions of their treaties with the PE state (State PE), despite the allocation of primary (or even exclusive) taxing rights to State PE under the R-PE treaty. The reasons for considering this the "wrong" treaty are discussed in depth in Chapter 5.
treaty. State PE does not have to provide relief under the PE-L treaty because State L is prevented from imposing tax on the income.

The recipient’s residence state (State R): State R must continue to apply the R-W treaty, the R-L treaty and the R-PE treaty. State R is obliged to provide relief under the R-PE treaty (either exemption or credit). To the extent that State R exempts the income under this treaty, no further relief would be required. If, however, State R uses the credit method of relief with respect to the income attributable to the PE, it will also have to provide a credit1521 for tax imposed in State W under the terms of the R-W treaty.1522 State R will not be obliged to provide relief under the R-L treaty, since State L is prevented from imposing tax under the terms of the PE-L treaty.

Overview: In this situation, the source states (State W and State L) will be subject to the conditions of their respective treaties with the recipient’s PE state (State PE) rather than their treaties with the recipients residence state (State R), which means that they are now applying the more appropriate treaty conditions. In State W, the treaty with State PE may provide a different maximum level of source-based taxation of dividends than the R-W treaty, and this would have an impact on the amount of tax that State W could impose. In addition, the dual-resident payor of the dividends will no longer be considered a resident of State L for the purposes of the R-L or PE-L treaties. As a result, State L will be prevented from imposing tax under the PE-L treaty and there will be no dual source-based taxation. Furthermore, State PE now has an explicit obligation to provide relief for tax imposed in State W under the terms of the PE-W treaty. State R will also be obliged to provide relief; if it uses the exemption method under the R-PE treaty then it will simply exempt the income, however, if State R uses the credit method under that treaty then it will also be obliged to provide a credit for tax imposed in State W. The combination of the relief in State PE and in State R will generally ensure that no unrelieved double taxation arises.

2.4. Interest
Interest is dealt with in Article 11, which allows the state where interest arises to impose a limited rate of tax. Article 11 reads as follows (paragraphs 1 and 2):

“1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest.”

Thus, where Article 11 applies, the source state is limited to imposing an amount of tax equal to 10% of the gross amount of the interest. This rate is a common point of negotiation, however, and often varies between concluded treaties. Furthermore, if the interest is attributable to a PE of the recipient which is located in the source state then, as a result of Article 11(4), Article 7 will apply instead of Article 11 and the source state may impose tax on the basis of the profit attributable to the PE.1523

1520 Where the treaty provides for the exemption method of relief under Article 23A, paragraph 2 nevertheless requires the residence state to grant relief using the credit method for income which may be taxed in the other contracting state under Article 10 (or Article 11).
1521 Where the treaty provides for the exemption method of relief under Article 23A, paragraph 2 nevertheless requires the residence state to grant relief using the credit method for income which may be taxed in the other contracting state under Article 10 (or Article 11).
1522 It is proposed that the residence state will continue to have an obligation for tax imposed in the source state(s) in PE triangular cases under a specific provision of the treaty (refer to Section A1.2.1.2., above). The residence state will not have a relief obligation if it is required to exempt the income under its treaty with the PE state or if the source state is prevented from imposing tax under its treaty with the PE state (the PE-S treaty). This proposal is discussed in much greater depth in Chapter 7 (Section 7.5.4.).
1523 Article 11(4) provides that: “The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises through a permanent establishment situated therein and the debt-claim in respect of which the interest
Whether interest arises in a particular state is determined in accordance with Article 11(5) which provides that:

“Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated.”

Thus, interest arises in a particular state if it is paid by a resident of that state or, in broad terms, is borne by a PE located in that state.

This section deals with a situation where a resident of State R derives interest income which is attributable to a PE in State PE. The interest is paid by a dual-resident, a person who is resident in two states (State W and State L) for treaty purposes; the payor’s residence is assigned to State W for the purposes of the W-L treaty. This situation is illustrated in the following diagram (in which “HO” denotes head office):

For a detailed discussion of PE triangular cases involving interest, refer to Chapter 2 (Section 2.5.2.). For a detailed discussion of reverse dual resident triangular cases, including a brief overview of the outcome in reverse dual-resident triangular cases involving interest, refer to Chapter 12 (Section 12.3.).

2.4.1. Existing treaty framework

The winning residence state of the payor (State W): State W must apply the conditions of the R-W treaty. Under Article 11(5) of this treaty, the interest will be considered to arise in State W since it is paid by a resident of that state. Article 11 of the treaty will therefore apply and State W will be entitled to impose a limited rate of tax on the interest.

The losing residence state of the payor (State L): State L must apply the conditions of the R-L treaty. Under Article 11(5) of this treaty, the interest will be considered to arise in State L since it is paid by a resident of that state. Article 11 of the treaty will therefore apply and State L will be entitled to impose a limited rate of tax on the interest.

The recipient’s PE state (State PE): State PE must apply the conditions of the R-PE treaty. For the purposes of the R-PE treaty, Article 7 will apply (since the interest is attributable to a PE located in State PE) and State PE will be entitled to impose tax on the profit attributable to the PE. State PE may also have an

is paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.”

1524 Article 11(5) provides that: “Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated.”

1525 Article 11(5) provides that: “Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated.”
obligation to provide relief for the tax imposed in the source states (State W and State L) under the non-discrimination article (Article 24(3)) of its treaty with State R, however, the scope of this obligation is not completely clear.1526 If State PE does grant relief under this provision, it would typically be credit relief given that the income involved is interest income. However, State PE may not be able to fully credit the tax imposed in both State W and State L.

The recipient’s residence state (State R): State R must apply the R-W treaty, the R-L treaty and the R-PE treaty. State R may impose tax, but each of these three treaties will require State R to provide relief. Under the R-W treaty and the R-L treaty this is likely to be credit relief (regardless of the general method of relief specified in the treaty) and under the R-PE treaty it may be either exemption or credit relief. Given that State R has an obligation to provide relief for tax imposed in three states it is unlikely to be able to provide sufficient relief to prevent unrelieved double taxation.1527

Overview: In this situation, tax may be imposed in all four states. For the purposes of the R-W treaty the interest is considered to arise in State W and for the purposes of the R-L treaty the interest is considered to arise in State L; both State W and State L may therefore impose tax on the interest under Article 11 of their respective treaties with State R. State PE may also impose tax on the basis of the profit attributable to the PE. Given that tax is imposed in four states, the relief granted in the residence state (and possibly the PE state) is unlikely to be sufficient to prevent double taxation. Furthermore, the source states (State W and State L) are arguably applying the conditions of the wrong treaty and should instead apply the conditions of their treaty with State PE.1528

2.4.2. Application of proposed solutions

The winning residence state of the payor (State W): Instead of applying the conditions of the R-W treaty, State W must now apply the conditions of the PE-W treaty. For the purposes of this treaty, the interest is paid by a resident of State W and therefore, Article 11 will apply. Under Article 11, State W will be entitled to impose a limited rate of tax on the interest.

The losing residence state of the payor (State L): Instead of applying the conditions of the R-L treaty, State L must now apply the conditions of the PE-L treaty. For treaty purposes the dual-resident of payor of the interest is no longer considered to be resident in State L for the purposes of treaties with third states (i.e., states other than State W). Therefore, for the purposes of the PE-L treaty, the interest will not be considered to be paid by a resident of State L and Article 11 will not apply. Instead, Article 7 or Article 21 will apply (depending on whether the interest is considered to be business profits) and State L will be prevented from imposing any tax.

The recipient’s PE state (State PE): State PE must continue to apply the conditions of the R-PE treaty. For the purposes of this treaty, the interest income is attributable to a PE located in State PE and therefore, as a result of Article 11(3), Article 7 will apply. Under Article 7, State PE will be entitled to impose tax on the profit attributable to the PE. State PE must now also apply the conditions of the PE-W treaty and the

1526 The PE state’s potential relief obligation under Article 24(3) is discussed in depth in Chapter 4. Article 24(3) requires that the tax imposed on the PE in the PE state be “not less favorably levied” than the tax imposed on a resident enterprise carrying on the same activities. It is quite clear that this requires the PE state to extend the benefit of any domestic relief provisions to the PE. It is less clear however, whether this also requires the PE state to extend to the PE any relief that would be available to local residents under the PE-S treaty. For detailed discussion of these issues, please refer to Chapter 4 (particularly Section 4.3.).

1527 Refer to Chapter 3 (Section 3.2.) for an analysis of the residence states capacity to provide sufficient relief to prevent unrelieved double taxation in PE triangular situations where the PE state does not provide any relief. Broadly, this will depend on the relative tax rates in the states involved and, where the residence state uses the credit method, will also depend on the applicable credit limitations.

1528 That is, the source states apply the conditions of their treaties with the residence state of the recipient of the income (State R) rather than the conditions of their treaties with the PE state (State PE), despite the allocation of primary (or even exclusive) taxing rights to State PE under the R-PE treaty. The reasons for considering this the “wrong” treaty are discussed in depth in Chapter 5.
PE-L treaty. State PE will be obliged to grant relief under the PE-W treaty (using the credit method) but, because State L is prevented from imposing tax, will not have any obligation to provide relief under the PE-L treaty.

The recipient’s residence state (State R): State R must continue to apply the R-W treaty, the R-L treaty and the R-PE treaty. State R may impose tax on the income, but will have an obligation to grant relief under both the R-PE treaty (credit or exemption) and the R-W treaty (using the credit method). However, no relief will be required for tax imposed in State W if State R exempts the income under the R-PE treaty. State R will also have no obligation to provide relief under the terms of the R-L treaty, since State L is prevented from imposing tax under the terms of the PE-L treaty.

Overview: The source states (State W and State L) will now be subject to the conditions of their respective treaties with the recipient’s PE state (State PE) rather than their treaties with the recipients residence state (State R) and are therefore applying the more appropriate treaty conditions. In State W, the treaty with State PE may provide a different maximum level of source-based taxation of interest than the R-W treaty and this would have an impact on the amount of tax that State W could impose. In addition, the dual-resident payor of the interest will no longer be considered a resident of State L for the purposes of the R-L or PE-L treaties. As a result, State L will be prevented from imposing tax under the PE-L treaty and there will be no dual source-based taxation. Furthermore, State PE now has an explicit obligation to provide relief for tax imposed in State W under the terms of the PE-W treaty. State R will also be obliged to provide relief; if it uses the exemption method under the R-PE treaty then it will simply exempt the income, however, if State R uses the credit method under that treaty then it will also be obliged to provide a credit for tax imposed in State W. The combination of the relief in State PE and in State R will generally ensure that no unrelieved double taxation arises.

2.5. Royalties

Royalties are dealt with in Article 12, which allows tax to be imposed only in the residence state. Article 12 (paragraph 1) reads as follows:

“Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State.”

If, however, the royalties are attributable to a PE of the recipient which is located in the source state, then as a result of Article 12(2), Article 7 will apply instead of Article 12 and the source state may impose tax on the basis of the profit attributable to the PE. Thus, the OECD Model does not allow any source-based taxation of royalties except where they are attributable to a PE in the source state.

As outlined in Chapter 12 (see Section 12.2.2.), the UN Model and many concluded treaties do allow states to impose a limited rate of source based taxation on royalties which arise in one contracting state and are paid to a resident of the other contracting state. In general, the rules for determining whether royalties arise in a particular state mirror the rules of Article 11(5) which apply in relation to interest. To the extent that the applicable treaties do allow source-based taxation of royalties and determine where royalties arise under a provision equivalent to Article 11(5), the analysis in relation to royalties would be

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1529 Where the treaty provides for the exemption method of relief under Article 23A, paragraph 2 nevertheless requires the residence state to grant relief using the credit method for income which may be taxed in the other contracting state under Article 11 (or Article 10).

1530 It is proposed that the residence state will continue to have an obligation for tax imposed in the source state(s) in PE triangular cases under a specific provision of the treaty (refer to Section A1.2.1.2., above). The residence state will not have a relief obligation if it is required to exempt the income under its treaty with the PE state or if the source state is prevented from imposing tax under its treaty with the PE state (the PE-S treaty). This proposal is discussed in much greater depth in Chapter 7 (Section 7.5.4.).

1531 See, for example, Article 12(5) of the UN Model Treaty (2001), which provides that: “Royalties shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties was incurred, and such royalties are borne by such permanent establishment or fixed base, then such royalties shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.”
This section deals with a situation where a person resident in State R derives royalties which are attributable to a PE located in State PE. The royalties are paid by a dual-resident, a person who is resident in two states (State W and State L) for treaty purposes. The payor's residence is assigned to State W for the purposes of the W-L treaty. This situation is illustrated in the following diagram (in which “HO” denotes head office):

For a detailed discussion of PE triangular cases involving royalties, refer to Chapter 2 (Section 2.5.3.). For more detailed discussion of reverse dual resident triangular cases, including a brief overview of the outcome in reverse dual-resident triangular cases involving royalties, refer to Chapter 12 (Section 12.3).

2.5.1. Existing treaty framework

The winning residence state of the payor (State W): State W must apply the conditions of the R-W treaty. For the purposes of this treaty Article 12 will generally apply and, depending on the terms of Article 12, State W will either be prevented from imposing tax (if the treaty follows the OECD Model) or will be entitled to impose tax on the royalties at a limited rate.1533

The losing residence state of the payor (State L): State L must apply the conditions of the R-L treaty. For the purposes of this treaty Article 12 will generally apply and, depending on the terms of Article 12, State L will either be prevented from imposing tax (if the treaty follows the OECD Model) or will be entitled to impose tax on the royalties at a limited rate.1534

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1533 This assumes that the royalties are considered to arise in State W for the purposes of the treaty, i.e., as a result of being paid by a resident of State W. This could occur under general principles or as a result of the application of a specific provision mirroring Article 11(5). If Article 12 does not allow any source based taxation of royalties, it may not contain a provision specifying where royalties are considered to arise. If this is the case and if, for some reason, the royalties are not considered to arise in State W, State W would still be prevented from imposing tax either under Article 7 or under Article 21 (depending on whether the royalties are considered to be business profits for the purposes of the treaty).

1534 This assumes that the royalties are considered to arise in State L, for the purposes of the treaty, i.e., as a result of being paid by a resident of State L. This could occur under general principles or as a result of the application of a specific provision mirroring Article 11(5). If Article 12 does not allow any source based taxation of royalties, it may not contain a provision specifying where royalties are considered to arise. If this is the case and if, for some reason, the royalties are not considered to arise in State L, State L would still be prevented from imposing tax either under
The recipient's PE state (State PE): State PE must apply the conditions of the R-PE treaty. For the purposes of this treaty, Article 7 will apply and State PE may impose tax on the basis of the profit attributable to the PE. To the extent that State W and/or State L has imposed source-based taxation on the royalties, State PE may be required to provide relief in accordance with the non-discrimination provision (Article 24(3)) of the R-PE treaty (typically credit relief). However, the scope of the PE state’s obligation to provide relief under Article 24(3) is not completely clear.1535

The recipient's residence state (State R): State R must apply the conditions of the R-PE treaty, the R-W treaty and the R-L treaty. To the extent that State W and/or State L is entitled to impose tax under their respective treaties with State R, State R will be obliged to provide relief (generally using the credit method). State W will also be obliged to provide relief (credit or exemption) under the R-PE treaty. To the extent that tax is imposed in State W and/or State L and in State PE, State R will have an obligation to provide relief under more than one treaty and is unlikely to be able to provide sufficient relief to prevent double taxation.1536

Overview: The existence of dual source-based taxation of royalties in this situation will depend on the terms of the applicable treaties; it may be that neither of the source states (State W and State L) is entitled to impose tax, that only one of those states is entitled to impose tax or that both those states are entitled to impose tax. Tax may also be imposed in State R and in State PE; State R will have a clear obligation to provide relief for tax imposed in any of the other three states, and State PE may have an obligation to provide relief for tax imposed in State W and/or State L under the non-discrimination provision of the R-PE treaty. However, in many cases unrelieved double taxation may persist. In addition, State W and State L are arguably applying the wrong treaty conditions (i.e., the conditions of their treaties with State R) and should instead apply the conditions of their respective treaties with State PE in relation to the income attributable to the PE located in that state.1537

2.5.2. Application of proposed solutions

The winning residence state of the payor (State W): Instead of applying the R-W treaty, State W will now apply the conditions of the PE-W treaty. For the purposes of the PE-W treaty, Article 12 will generally apply and, depending on the terms of Article 12, State W will either be prevented from imposing tax (if the treaty follows the OECD Model) or will be entitled to impose tax on the royalties at a limited rate.1538

The losing residence state of the payor (State L): Similarly, instead of applying the R-L treaty, State L will now apply the conditions of the PE-L treaty. However, the dual-resident payor will no longer be considered a resident of State L for the purposes of State L’s tax treaties, including the PE-L treaty. As a result, the

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1535 The PE state’s potential relief obligation under Article 24(3) is discussed in depth in Chapter 4. Article 24(3) requires that the tax imposed on the PE in the PE state be “not less favorably levied” than the tax imposed on a resident enterprise carrying on the same activities. It is quite clear that this requires the PE state to extend the benefit of any domestic relief provisions to the PE. It is less clear however, whether this also requires the PE state to extend to the PE any relief that would be available to local residents under the PE-S treaty. For detailed discussion of these issues, please refer to Chapter 4 (particularly Section 4.3.).

1536 Refer to Chapter 3 (Section 3.2.) for an analysis of the residence states capacity to provide sufficient relief to prevent unrelieved double taxation in PE triangular situations where the PE state does not provide any relief. Broadly, this will depend on the relative tax rates in the states involved and, where the residence state uses the credit method, will also depend on the applicable credit limitations.

1537 For an in-depth discussion of the appropriate treaty conditions to apply in the source state in PE triangular cases, please refer to Chapter 5.

1538 This assumes that the royalties are considered to arise in State W for the purposes of the treaty, i.e., as a result of being paid by a resident of State W. This could occur under general principles or as a result of the application of a specific provision mirroring Article 11(5). If Article 12 does not allow any source based taxation of royalties, it may not contain a provision specifying where royalties are considered to arise. If this is the case and if, for some reason, the royalties are not considered to arise in State W, State W would still be prevented from imposing tax either under Article 7 or under Article 21 (depending on whether the royalties are considered to be business profits for the purposes of the treaty).
royalties may not be considered to arise in State L, and Article 12 will generally not apply. Instead, the income may fall under either Article 7 or Article 21 depending on whether it is considered to be business profits. Irrespective of which of these two provisions applies, State L will be prevented from imposing tax.

The recipient’s PE state (State PE): State PE will continue to apply the conditions of the R-PE treaty and will continue to be entitled to impose tax on the profit attributable to the PE in accordance with Article 7. However, to the extent that State W is entitled to impose tax on the income in accordance with the PE-W treaty, State PE will now have an explicit obligation to grant relief under the terms of that treaty.

The recipient’s residence state (State R): State R will continue to apply the conditions of the R-PE treaty, the R-W treaty and the R-L treaty. State R will continue to have an obligation to provide relief using either the exemption or credit method under the R-PE treaty. If State R uses the credit method of relief in relation to the profit attributable to the PE, and if State W is entitled to impose tax under the PE-S treaty, State R will also have an obligation to provide relief for tax imposed in State W.

Overview: Ensuring that a dual-resident is not resident in its losing residence state for the purposes of treaties between that state and third states prevents dual source-based taxation in situations where royalties are paid by a dual-resident to a resident of a third state. In the situation discussed in this section, this means that State L is prevented from imposing tax. State W may or may not be entitled to impose tax depending on whether the PE-W treaty allows source-based taxation of royalties. Depending on the terms of the applicable treaties, tax may therefore be imposed in only one of the source states (State W) or they may both be prevented from imposing tax. Furthermore, due to the application of the treaties between the recipient’s PE state (State PE) and the source states, the source states are now applying the more appropriate treaty provisions. State PE will also have an explicit relief obligation in situations where State W is entitled to impose tax. State R will have an obligation to provide relief for tax imposed in the PE state (State PE) and, if it uses the credit method with respect to the profit attributable to the PE and State W is not prevented from imposing tax under the PE-W treaty, will also have an obligation to provide relief for tax imposed in State W. This relief, combined with the relief in the PE state, ensures that double taxation can be prevented.

2.6. Income from immovable property

Income from immovable property is dealt with in Article 6, which allows the state where the property is located to impose tax on the income. Article 6 (paragraph 1) provides as follows:

“Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.”

Immovable property is defined in Article 6(2) by reference to the domestic law of the state where the property is located. Article 6(2) also lists certain things, such as property accessory to immovable property and livestock, which are always considered to be immovable property for the purposes of the treaty.

1539 Assuming that royalties are only considered to arise in a particular state for treaty purposes if they are either paid by a resident of that state or originate in a PE of the payor located in that state, i.e., mirroring the provisions of Article 11(5) which determines where interest arises.

1540 It is proposed that the residence state will continue to have an obligation for tax imposed in the source state(s) in PE triangular cases under a specific provision of the treaty (refer to Section A1.2.1.2., above). The residence state will not have a relief obligation if it is required to exempt the income under its treaty with the PE state or if the source state (in this case, State W) is prevented from imposing tax under its treaty with the PE state. This proposal is discussed in much greater depth in Chapter 7 (Section 7.5.4.).

1541 Article 6(2) provides that: “The term ‘immovable property’ shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.”
Where immovable property is located in a third state for the purposes of a particular treaty, there is some debate regarding the appropriate treaty article to apply.\textsuperscript{1542} This was discussed in detail in Chapter 2 (see Section 2.6.), where it was concluded that the income may fall under the distributive rule of either Article 7 or Article 21. Article 7 may apply either because the income is considered to be business profits or because is attributable to a PE (i.e., as a result of Article 21(2)). It will generally fall under Article 21 only if it is not considered to be business profits and is not attributable to a PE. For a detailed discussion, please refer to Chapter 2 (Section 2.6.).

This section deals with a situation where a person resident in State R derives income from immovable property which is attributable to a PE located in State PE. The income is paid by a dual-resident, a person who is resident in two states (State W and State L) for treaty purposes. The payor's residence is assigned to State W for the purposes of the W-L treaty. As mentioned above, the application of tax treaties in relation to income from immovable property depends on the location of the property. For the purposes of the analysis below, it is assumed that the immovable property is located in State W. This situation is illustrated in the following diagram (in which “HO” denotes head office):

For a detailed discussion of PE triangular cases involving income from immovable property, refer to Chapter 2 (Section 2.6.). For more detailed discussion of reverse dual resident triangular cases, including a brief overview of the outcome in reverse dual-resident triangular cases involving income from immovable property, refer to Chapter 12 (Section 12.3.).

2.6.1. Existing treaty framework

The winning residence state of the payor (State W): State W must apply the conditions of the R-W treaty. For the purposes of this treaty, Article 6 applies and State W may impose tax on the income. Note that if the property were instead located in another state, e.g., State L, then Article 6 would not apply. Instead, Article 7 or Article 21 applies (depending on whether the income is considered to be business profits)\textsuperscript{1543} and State W would be prevented from imposing tax on the income.

The losing residence state of the payor (State L): State L must apply the conditions of the R-L treaty. Article 6 will not apply for the purposes of this treaty because the immovable property is not located in State L.


\textsuperscript{1543} For a discussion of the appropriate treaty article to apply in relation to income from immovable property where the immovable property is located in a third state, please refer to Chapter 2 (Section 2.6.). As mentioned above, Article 6 will not apply because the definition of immovable property only applies where the property is located in one of the contracting states. Where the income is attributable to a PE (i.e., for the purposes of the R-PE treaty), the income will fall under the distributive rule of Article 7 (either directly because it is considered to be business profits, or indirectly as a result of Article 21(2)). Please refer to Chapter 2 for an in-depth discussion of the application of tax treaties in PE triangular cases involving immovable property (Section 2.6.).
Instead, Article 7 or Article 21 applies, depending on whether the income is considered to be business profits, and because the income is not attributable to a PE in State L, State L would be prevented from imposing tax. Note that if the property were instead located in State L, then State L would be entitled to impose tax on the income under Article 6.

The recipient’s PE state (State PE): State PE must apply the conditions of the R-PE treaty. For the purpose of this treaty, the income will fall under Article 7 (either directly because it is considered to be business profits, or indirectly as a result of Article 21(2)) and State PE will be entitled to impose tax on the profit attributable to the PE. State PE may also have an obligation to provide relief for tax imposed in State W (i.e., the state where the property is located) under the non-discrimination provision (Article 24(3)) of its treaty with State R.

The recipient’s residence state (State R): State R must apply the conditions of the R-W treaty, the R-L treaty and the R-PE treaty. State R may impose tax but will have an obligation to provide relief (either exemption or credit) under both the R-W treaty and the R-PE treaty. State R will not have a relief obligation under the R-L treaty because the terms of that treaty do not allow State L to impose any tax on the income.

Overview: In this situation, tax is imposed in the state where the property is located (State W), State PE and State R. The fact that the payment is made by a dual resident does not give rise to dual source-based taxation. State R will have a clear obligation to provide relief for tax imposed in both State PE and State W, but is unlikely to be able to provide sufficient relief in the absence of relief in the PE state (refer to discussion in Chapter 3). State PE may have an obligation to provide relief under Article 24(3), but the scope of this relief obligation is subject to debate. Thus, unrelieved double taxation may arise. In addition, State W and State L are arguably applying the wrong treaty conditions (i.e., the conditions of their treaties with State R) and should instead apply the conditions of their respective treaties with State PE.

2.6.2. Application of proposed solutions

The winning residence state of the payor (State W): Instead of applying the conditions of the R-W treaty, State W will now apply the conditions of the PE-W treaty. For the purposes of the PE-W treaty, Article 6 will apply and State W will continue to be entitled to impose tax on the income. The application of the PE-W treaty instead of the R-W treaty is unlikely to have any practical impact in State W, particularly given that the definition of immovable property in Article 6 refers to the domestic law of the state where the property is located.

1544 For a discussion of the appropriate treaty article to apply in relation to income from immovable property where the immovable property is located in a third state, please refer to Chapter 2 (Section 2.6.). As mentioned above, Article 6 will not apply because the definition of immovable property only applies where the property is located in one of the contracting states. Where the income is attributable to a PE (i.e., for the purposes of the R-PE treaty), the income will fall under the distributive rule of Article 7 (either directly because it is considered to be business profits, or indirectly as a result of Article 21(2)). Please refer to Chapter 2 for an in-depth discussion of the application of tax treaties in PE triangular cases involving immovable property (Section 2.6.).

1545 The PE state’s potential relief obligation under Article 24(3) is discussed in depth in Chapter 4. Article 24(3) requires that the tax imposed on the PE in the PE state be “not less favorably levied” than the tax imposed on a resident enterprise carrying on the same activities. It is quite clear that this requires the PE state to extend the benefit of any domestic relief provisions to the PE. It is less clear however, whether this also requires the PE state to extend to the PE any relief that would be available to local residents under the PE-S treaty. For detailed discussion of these issues, please refer to Chapter 4 (particularly Section 4.3.).

1546 Refer to Chapter 3 (Section 3.2.) for an analysis of the residence states capacity to provide sufficient relief to prevent unrelieved double taxation in PE triangular situations where the PE state does not provide any relief. Broadly, this will depend on the relative tax rates in the states involved and, where the residence state uses the credit method, will also depend on the applicable credit limitations. Chapter 3 also discusses the residence state’s potential option to grant dual relief (see Section 3.3.).

1547 For an in-depth discussion of the appropriate treaty conditions to apply in the source state in PE triangular cases, please refer to Chapter 5.
The losing residence state of the payor (State L): Instead of applying the conditions of the R-L treaty, State L must now apply the conditions of the PE-L treaty. For the purposes of this treaty, Article 7 or Article 21 will apply (depending on whether the income is considered to be business profits) and State L will continue to be prevented from imposing any tax on the income.

The recipient’s PE state (State PE): State PE will continue to apply the R-PE treaty and will continue to be entitled to impose tax on the profits attributable to the PE under Article 7. However, State PE will now have an explicit obligation to provide relief (either exemption or credit) under the terms of the PE-W treaty (i.e., its treaty with the state where the immovable property is located).

The recipient’s residence state (State R): State R must continue to apply the conditions of the R-W treaty, the R-L treaty and the R-PE treaty. State R will therefore continue to have an obligation to provide relief under the R-PE treaty. If State R provides relief under the R-PE treaty using the credit method, it will also have an obligation to provide relief under the R-W treaty (using either the credit or exemption method).

Overview: The main impact of the proposed solution in this case is the explicit obligation imposed on the PE state to provide relief for tax imposed in the state where the property is located. Although the source states (State W and State L) are now applying the more appropriate treaty conditions, this is likely to have little practical impact since the terms of Article 6 are less likely to differ between treaties than, for example, the maximum rates of tax that can be imposed on passive income. In addition, the residence of the payor has no impact on the distribution of taxing rights with respect to income dealt with under Article 6 and, as a result, the fact that the dual-resident payor is no longer considered to be resident in State L for the purposes of the R-L treaty will have no impact on the outcome in this case.

2.7. Income from shipping and air transport

Article 8 deals with income from shipping, inland waterways transport and air transport and provides (in paragraphs 1 and 2) that:

“1. Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

2. Profits from the operation of boats engaged in inland waterways transport shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.”

Thus, under Article 8, income from shipping, inland waterways transport and air transport may only be taxed in the state where the enterprise’s place of effective management is located. This will generally be the state where the person deriving the income is resident.

This section deals with a situation where a person resident in State R derives income from shipping, inland waterways transport and/or air transport which is attributable to a PE in State PE. The place of effective management of the person deriving the income is located in that person’s residence state, State R. The income is paid by a dual-resident, a person who is resident in two states (State W and State L) for treaty purposes. The payor’s residence is assigned to State W for the purposes of the W-L treaty. This situation is illustrated in the following diagram (in which “HO” denotes head office and “POEM” denotes the place of effective management of the person deriving the income):

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1548 It is proposed that the residence state will continue to have an obligation for tax imposed in the source state(s) in PE triangular cases under a specific provision of its treaties with those states (refer to Section 1.2.1.2., above). The residence state will not have a relief obligation if it is required to exempt the income under its treaty with the PE state or if the source state is prevented from imposing tax under its treaty with the PE state (the PE-S treaty). This proposal is discussed in much greater depth in Chapter 7 (Section 7.5.4).

1549 The place of effective management is assumed to be located in the residence state for the purposes of the discussion below. For further discussion of the location of the place of effective management in the context of applying tax treaties in PE triangular cases involving income from shipping, inland waterways transport and air transport, please refer to Chapter 2 (Section 2.7.).
For a more detailed discussion of typical PE triangular cases involving income from shipping, inland waterways transport and air transport, refer to Chapter 2 (Section 2.7.). For more detailed discussion of reverse dual resident triangular cases, including a brief overview of the outcome in reverse dual-resident triangular cases involving income dealt with under Article 8, refer to Chapter 12 (Section 12.3.).

2.7.1. Existing treaty framework

The winning residence state of the payor (State W): State W must apply the conditions of the R-W treaty. For the purposes of this treaty Article 8 will apply and, since the place of effective management is located in State R, State W will be prevented from imposing any tax on the income.

The losing residence state of the payor (State L): State L must apply the conditions of the R-L treaty. Again, Article 8 of the treaty will apply and, since the place of effective management is located in State R, State L will be prevented from imposing any tax on the income.

The recipient’s PE state (State PE): State PE must apply the conditions of the R-PE treaty. Article 8 will also apply for the purposes of this treaty and, since the place of effective management is located in State R, State PE will be prevented from imposing any tax on the income.

The recipient’s residence state (State R): State R must apply the R-W treaty, the R-L treaty and the R-PE treaty. There will be no limitation on State R’s ability to impose tax and, since no other state may impose tax on the income, State R will have no obligation to provide relief.

Overview: In this situation, tax may only be imposed in State R; all the other states involved will be prevented from imposing tax under Article 8 of their respective treaties with State R.

2.7.2. Application of proposed solutions

It is not proposed that the benefits of treaties concluded between the PE state and third states should be available in situations where the PE state is prevented from imposing tax under the conditions of the R-PE treaty, as is the case with respect to income from shipping, inland waterways transport and air transport under Article 8. The following discussion is therefore intended to deal only with the impact of the proposed solution for reverse dual-resident triangular cases.

The winning residence state of the payor (State W): State W must continue to apply the conditions of the R-W treaty. For the purposes of this treaty Article 8 will apply and, since the place of effective management of the person deriving the income is located in State R, State W will be prevented from imposing any tax on the income.

The losing residence state of the payor (State L): State L must continue apply the conditions of the R-L treaty. Again, Article 8 of the treaty will apply and, since the place of effective management is located in State R, State L will be prevented from imposing any tax on the income. The fact that the person paying the amount in question is no longer considered to be a resident of State L for the purpose of the R-L treaty has no impact on this outcome.

1550 Refer to Chapter 8 (Section 8.6.5.) for further discussion.
The recipient’s PE state (State PE): State PE must apply the conditions of the R-PE treaty. Article 8 will also apply for the purposes of this treaty and, since the place of effective management is located in State R, State PE will be prevented from imposing any tax on the income.

The recipient’s residence state (State R): State R must apply the R-W treaty, the R-L treaty and the R-PE treaty. There will be no limitation on State R’s ability to impose tax and, since no other state may impose tax on the income, State R will have no obligation to provide relief.

Overview: In this situation, as under the existing treaty framework, tax may only be imposed in State R; all the other states involved will be prevented from imposing tax under Article 8 of their respective treaties with State R. Furthermore, the residence of the payor has no impact on the distribution of taxing rights with respect to income dealt with under Article 8 and, as a result, the fact that the dual-resident payor is no longer considered to be resident in State L for the purposes of the R-L treaty will have no impact on the outcome in this case.

2.8. Capital gains from the alienation of immovable property

Capital gains derived from the alienation of immovable property are dealt with in Article 13(1), which provides as follows:

“Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.”

Thus, Article 13(1) applies where a resident of one state derives capital gains from the alienation of immovable property located in the other contracting state, and allows the state where the property is located to impose tax on the gain. The reference to Article 6 in Article 13(1) is a reference to the definition of immovable property, which in turn refers to the domestic law of the state where the property is located, as well as containing a list of certain property which is always considered to be immovable property for the purposes of the treaty.1551

This section deals with a situation where a person resident in State R derives a capital gain from the alienation of immovable property and that capital gain is attributable to a PE of the recipient located in State PE. The property is purchased by a dual-resident, a person who is resident in two states (State W and State L) for treaty purposes. The payor’s residence is assigned to State W for the purposes of the W-L treaty. It is assumed that the immovable property from which the gain arises is located in State W. This situation is illustrated in the diagram below (in which “HO” denotes head office):

For further discussion of Article 13(1) and of typical PE triangular cases involving capital gains from the alienation of immovable property, refer to Chapter 2 (Section 2.8.1.). For more detailed discussion of reverse dual resident triangular cases, including a brief overview of the outcome in reverse dual-resident triangular cases involving this type of capital gains, refer to Chapter 12 (Section 12.3.).

2.8.1. Existing treaty framework

1551 For further discussion of the definition of immovable property and the application of tax treaties in PE triangular cases involving capital gains from immovable property, please refer to Chapter 2 (particularly Section 2.8.1.).
The winning residence state of the payor (State W): State W must apply the conditions of the R-W treaty. For the purposes of this treaty, Article 13(1) applies and State W will be entitled to impose tax on the capital gain.

The losing residence state of the payor (State L): State L must apply the conditions of the R-L treaty. For the purposes of this treaty, Article 13(1) will not apply because the property is not located in either of the contracting states. Instead, Article 13(5) will apply (since none of the other paragraphs of Article 13 apply) and State L will be prevented from imposing tax on the capital gain.

The recipient’s PE state (State PE): State PE must apply the conditions of the R-PE treaty. For the purposes of this treaty, Article 13(1) will not apply because the property is not located in either of the contracting states. Instead, Article 13(5) will apply (since none of the other paragraphs of Article 13 apply) and State PE will be prevented from imposing tax on the capital gain.

The recipient’s residence state (State R): State R must apply the conditions of the R-W treaty, the R-L treaty and the R-PE treaty. There will be no restrictions on State R’s ability to impose tax, but State R will be required to provide relief (either exemption or credit) under the R-W treaty.

Overview: In this situation, tax may be imposed in the state where the immovable property is located and in the residence state of the person deriving the capital gain, and the residence state is obliged to provide relief (either exemption or credit, depending on the terms of the treaty). There is therefore no unrelieved double taxation; this is to be expected since the existence of a PE or the fact that the payment giving rise to the capital gain is made by a resident person, does not have any influence on a state’s ability to impose tax.

2.8.2. Application of proposed solutions

It is not proposed that the benefits of treaties concluded between the PE state and third states should be available in situations where the PE state is prevented from imposing tax under the conditions of the R-PE treaty, as is the case with respect to capital gains from the alienation of immovable property located in third states. The following discussion is therefore intended to deal only with the impact of the proposed solution for reverse dual-resident triangular cases.

The winning residence state of the payor (State W): State W must continue to apply the conditions of the R-W treaty. For the purposes of this treaty, Article 13(1) applies and (since the property is located in State W) State W will be entitled to impose tax on the gain.

The losing residence state of the payor (State L): State L must continue to apply the conditions of the R-L treaty. For the purposes of this treaty, Article 13(1) will not apply because the property is not located in either of the contracting states. Instead, Article 13(5) will apply (since none of the other paragraphs of Article 13 apply) and State L will be prevented from imposing tax on the capital gain. Note that the person paying the amount in question will no longer be a resident of State L for the purposes of the R-L treaty, but this will have no impact on the application of that treaty.

The recipient’s PE state (State PE): State PE must apply the conditions of the R-PE treaty. For the purposes of this treaty, Article 13(1) will not apply because the property is not located in either of the contracting states. Instead, Article 13(5) will apply (since none of the other paragraphs of Article 13 apply) and State PE will be prevented from imposing tax on the capital gain.

The recipient’s residence state (State R): State R must apply the conditions of the R-W treaty, the R-L treaty and the R-PE treaty. There will be no restrictions on State R’s ability to impose tax, but State R will be required to provide relief (either exemption or credit) under the R-W treaty.

1552 Article 13(5) provides that: “Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident.” The other paragraphs of Article 13 deal with capital gains arising from the alienation of movable property forming part of the business property of a PE (para 2), capital gains from the alienation of ships or aircraft in international traffic (and associated assets) (para 3), and capital gains from the alienation of shares deriving more than 50% of their value from immovable property (para. 4).

1553 Refer to Chapter 8 (Section 8.6.5.) for further discussion.
Overview: The proposed changes have no impact in this situation, partly because the source states will continue applying their treaties with the residence state (rather than the PE state) and partly because the residence of the payor has no impact on the distribution of taxing rights with respect to this category of capital gains. As under the existing treaty framework, tax may be imposed in the state where the property is located (State W) and in the residence state of the recipient (State R), and State R will have an obligation to provide relief. There will be no unrelieved double taxation. It should also be noted that the residence of the payor has no impact on the distribution of taxing rights with respect to capital gains dealt with under Article 13(1) and, as a result, the fact that the dual-resident payor is no longer considered to be resident in State L for the purposes of the R-L treaty will have no impact on the outcome in this case.

2.9. Capital gains from the alienation of movable property of a PE

Article 13(2) deals with capital gains from the alienation of movable property forming part of the business property of a PE. It provides that:

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

This section discusses a situation where a person resident in State R derives a capital gain from the alienation of movable property which forms part of the business property of a PE located in State PE. The property is purchased by a dual-resident, a person who is resident in two states (State W and State L) for treaty purposes. The payor’s residence is assigned to State W for the purposes of the W-L treaty. This situation is illustrated in the following diagram (in which “HO” denotes head office):

For further discussion of Article 13(2) and of typical PE triangular cases involving capital gains from the alienation of movable property forming part of the business property of a PE, refer to Chapter 2 (Section 2.8.2.). For more detailed discussion of reverse dual resident triangular cases, including a brief overview of the outcome in reverse dual-resident triangular cases involving capital gains dealt with under Article 13(2), refer to Chapter 12 (Section 12.3.).

2.9.1. Existing treaty framework

The winning residence state of the payor (State W): State W must apply the conditions of the R-W treaty. For the purposes of this treaty, Article 13(2) will not apply because the gain does not arise from the alienation of movable property of a PE located in State W. Since none of the other paragraphs of Article 13 apply, Article 13(5) will apply and State W will be prevented from imposing any tax on the gain.1554

The losing residence state of the payor (State L): State L must apply the conditions of the R-L treaty. For the purposes of this treaty, Article 13(2) will not apply because the gain does not arise from the alienation of movable property of a PE located in State L. Since none of the other paragraphs of Article 13 apply, Article 13(5) will apply and State L will be prevented from imposing any tax on the gain.

1554 Article 13(5) provides that: “Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident.” The other paragraphs of Article 13 deal with capital gains arising from the alienation of immovable property (para 1), capital gains from the alienation of ships or aircraft in international traffic (and associated assets) (para 3), and capital gains from the alienation of shares deriving more than 50% of their value from immovable property (para. 4).
The recipient's PE state (State PE): State PE must apply the conditions of the R-PE treaty. For the purposes of this treaty Article 13(2) will apply and State PE will be entitled to impose tax on the gain.

The recipient’s residence state (State R): State R must apply the conditions of the R-W treaty, the R-L treaty, and the R-PE treaty. State R may impose tax on the gain but will be obliged to provide relief (either exemption or credit) under the R-PE treaty. State R will have no obligation to provide relief under either the R-W treaty or the R-L treaty, since both State W and State L are prevented from imposing tax under their respective treaties with State R.

Overview: Tax may be imposed in State R and in State PE, and State R must provide relief. There is no dual source-based taxation and no unrelieved double taxation, however State W and State L are nevertheless still applying the wrong treaty conditions.\footnote{For an in-depth discussion of the appropriate treaty conditions to apply in the source state in PE triangular cases, please refer to Chapter 5.}

2.9.2. Application of proposed solutions

The winning residence state of the payor (State W): Instead of applying the R-W treaty, State W must now apply the conditions of the PE-W treaty. For the purposes of this treaty, Article 13(2) will not apply because the capital gain does not arise from the alienation of movable property forming part of the business property of a PE located in State W. Instead, since none of the other paragraphs of Article 13 apply, Article 13(5) will apply and State W will be prevented from imposing any tax on the gain. Thus, the application of the PE-W treaty instead of the R-W treaty would generally have no practical impact in State W.

The losing residence state of the payor (State L): Instead of applying the conditions of the R-L treaty, State L must now apply the conditions of the PE-L treaty. For the purposes of this treaty, Article 13(2) will not apply because the capital gain does not arise from the alienation of movable property forming part of the business property of a PE located in State L. Instead, since none of the other paragraphs of Article 13 apply, Article 13(5) will apply and State L will be prevented from imposing any tax on the gain. Thus, the application of the PE-L treaty instead of the R-L treaty would generally have no practical impact in State L. In addition, the payor will no longer be resident in State L for the purposes of that state’s treaties, including the PE-L treaty, however this will have no impact on the application of that treaty in this case.

The recipient’s PE state (State PE): State PE will continue to be bound by the conditions of the R-PE treaty and may continue to impose tax under Article 13(2) of that treaty. State PE must also apply the conditions of the PE-W treaty and the PE-L treaty, however, given that both State W and State L are prevented from imposing tax under these treaties, State PE will have no obligation to provide relief.

The recipient’s residence state (State R): State R must apply the R-W treaty, the R-L treaty and the R-PE treaty. State R will continue to have an obligation to provide relief under the R-L treaty, using either the exemption or credit method depending on the treaty. State R will not have any obligation to provide relief under the R-W treaty or the R-L treaty because both State W and State L are prevented from imposing tax under their respective treaties with State PE.\footnote{It is proposed that the residence state will continue to have an obligation for tax imposed in the source state(s) in PE triangular cases under a specific provision of its treaties with those states (refer to Section A1.2.1.2., above). The residence state will not have a relief obligation if it is required to exempt the income under its treaty with the PE state or if the source state is prevented from imposing tax under its treaty with the PE state (the PE-S treaty). This proposal is discussed in much greater depth in Chapter 7 (Section 7.5.4.).}

Overview: In this situation, the application of the treaties between the PE state of the person receiving the capital gain and the source states states has no practical impact on the ability of each state to impose tax, and no impact on the overall outcome. This is because there is no difference between the conditions of those states’ treaties with State R and their treaties with State PE. In practice, there could potentially be differences between the terms of these treaties, in which case the application of the latter treaties may have an impact on the source state’s ability to impose tax in this situation. In addition, the fact that the dual resident payor is no longer resident in State L for the purposes of the R-L treaty or the PE-L treaty...
will have no impact on the application of these treaties, since the residence of the payor has no impact on the distribution of taxing rights in relation to capital gains dealt with under Article 13(2).

2.10. Capital gains from the alienation of ships and aircraft in international traffic

Article 13(3) deals with capital gains from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport and associated assets. It provides that:

“Gains from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport or movable property pertaining to the operation of such ships, aircraft or boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.”

This section deals with a situation where a person resident in State R derives a capital gain from the alienation of ships or aircraft operated in international traffic (or similar assets), and that capital gain is attributable to a PE located in State PE. The place of effective management of the person deriving the capital gain is located in State R. The property is purchased by a dual-resident, a person who is resident in two states (State W and State L) for treaty purposes. The payor’s residence is assigned to State W for the purposes of the W-L treaty. This situation is illustrated in the following diagram (in which “HO” denotes head office and “POEM” denotes the place of effective management of the person deriving the capital gain):

For further discussion of Article 13(3) and of typical PE triangular cases involving capital gains from the alienation of ships or aircraft operated in international traffic, refer to Chapter 2 (Section 2.8.3.). For more detailed discussion of reverse dual resident triangular cases, including a brief overview of the outcome in reverse dual-resident triangular cases involving capital gains dealt with under Article 13(3), refer to Chapter 12 (Section 12.3.).

2.10.1. Existing treaty framework

The winning residence state of the payor (State W): State W must apply the conditions of the R-W treaty. For the purposes of this treaty, Article 13(3) will apply and, since the place of effective management of the enterprise deriving the gain is located in State R, State W will be prevented from imposing any tax.

The losing residence state of the payor (State L): State L must apply the conditions of the R-L treaty. For the purposes of this treaty, Article 13(3) will apply and State L will be prevented from imposing any tax.

The recipient’s PE state (State PE): State PE must apply the conditions of the R-PE treaty. For the purposes of this treaty, Article 13(3) will apply and State PE will be prevented from imposing any tax. The fact that the gain is attributable to a PE in State PE has no impact on the application of the treaty.

The recipient’s residence state (State R): State R must apply the conditions of the R-W treaty, the R-L treaty and the R-PE treaty. None of these treaties will impose any restriction on State R’s ability to impose tax and State R will have no obligation to provide relief.

Overview: In this situation, tax may only be imposed in State R. State W, State L and State PE will all be prevented from imposing tax under Article 13(3) of their respective treaties with State R.
2.10.2. Application of proposed solutions

It is not proposed that the benefits of treaties concluded between the PE state and third states should be available in situations where the PE state is prevented from imposing tax under the conditions of the R-PE treaty, as is the case with respect to capital gains from the alienation of ships, aircraft and associated assets.\(^{1557}\) The following discussion is therefore intended to deal only with the impact of the proposed solution for reverse dual-resident triangular cases.

**The winning residence state of the payor (State L):** State W must continue to apply the conditions of the R-W treaty. For the purposes of this treaty, Article 13(3) will apply and, since the place of effective management of the enterprise deriving the gain is located in State R, State W will be prevented from imposing any tax on the capital gain.

**The losing residence state of the payor (State L):** State L must continue to apply the conditions of the R-L treaty. For the purposes of this treaty, Article 13(3) will apply and, since the place of effective management of the enterprise deriving the gain is located in State R, State L will be prevented from imposing any tax on the capital gain. Note that the fact that the payor is no longer resident in State L for the purpose of the R-L treaty will have no impact on the application of the treaty in this case.

**The recipient’s PE state (State PE):** State PE must continue to apply the conditions of the R-PE treaty. For the purposes of this treaty, Article 13(3) will apply and State PE will be prevented from imposing any tax on the gain. The fact that the gain is attributable to a PE in State PE has no impact on the application of the treaty.

**The recipient’s residence state (State R):** State R must apply the conditions of the R-W treaty, the R-L treaty and the R-PE treaty. None of these treaties will impose any restriction on State R’s ability to impose tax and State R will have no obligation to provide relief.

**Overview:** The proposed changes have no impact in this situation, partly because the source states will continue applying their treaties with the residence state (rather than their treaties with the PE state) and partly because the residence of the payor has no impact on the distribution of taxing rights with respect to this type of capital gains. As under the existing treaty framework, tax may be only be imposed in the state where the place of effective management of the person deriving the capital gain is located (State R). It should also be noted that the residence of the payor has no impact on the distribution of taxing rights with respect to capital gains dealt with under Article 13(3) and, as a result, the fact that the dual-resident payor is no longer considered to be resident in State L for the purposes of the R-L treaty will have no impact on the outcome in this case.

2.11. Capital gains from the alienation of shares in a real estate company

Article 13(4) deals with capital gains from the alienation of shares which derive their value from immovable property. It provides as follows:

“Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.”

Such gains may therefore be taxed in the state where the underlying immovable property is located. The OECD Model does not contain any other specific provision dealing with shares, but some concluded treaties also allow source based taxation of gains arising from:

5. The alienation of shares in a company having more than 50% of its assets located in the source state;\(^{1558}\) and/or

6. The alienation of shares where the person disposing of those shares has a "substantial participation" (i.e., a shareholding of more than a certain specified percentage) in the company whose shares are being alienated.\(^{1559}\)

\(^{1557}\) Refer to Chapter 8 (Section 8.6.5.) for further discussion.

In general, these provisions allow the source state (i.e., the state where the underlying property is located) to impose tax on the gains in the same way as Article 13(4) allows taxation of gains arising from shares in a real estate company. For the purposes of the discussion below, however, it will be assumed that all the applicable treaties follow the OECD Model.

This section deals with a situation where a person resident in State R derives a capital gain from the alienation of shares which derive more than 50% of their value from immovable property, and that capital gain is attributable to a PE located in State PE. The amount giving rise to the capital gain is paid by a dual-resident, a person who is resident in two states (State W and State L) for treaty purposes. The payor’s residence is assigned to State W for the purposes of the W-L treaty. For the purposes of the discussion below, it is assumed that the underlying immovable property is located in State W. This situation is illustrated in the following diagram (in which “HO” denotes head office):

Note that the place where the shares are registered is not relevant for the purposes of the discussion below.

For additional discussion of PE triangular cases involving capital gains arising from the alienation of shares deriving more than 50% of their value from immovable property (and similar cases), refer to Chapter 2 (Section 2.8.4.). For more detailed discussion of reverse dual resident triangular cases, including a brief overview of the outcome in reverse dual-resident triangular cases involving capital gains dealt with under Article 13(4), refer to Chapter 12 (Section 12.3.).

2.11.1. Existing treaty framework

The winning residence state of the payor (State W): State W must apply the conditions of the R-W treaty. For the purposes of this treaty, Article 13(4) will apply and State W will be entitled to impose tax on the gain.

The losing residence state of the payor (State L): State L must apply the conditions of the R-L treaty. Article 13(4) of the treaty will not apply because the underlying property is not located in State L. Instead, since none of the other paragraphs of Article 13 apply, the capital gain will fall under Article 13(5) and State L will be prevented from imposing tax.\(^\text{1560}\)

The recipient’s PE state (State PE): State PE must apply the conditions of the R-PE treaty. For the purposes of this treaty, Article 13(4) will not apply because the underlying property is not located in State PE. However, the shares are likely to be considered movable property and, since the gain is attributable to the PE, is likely to form part of the business property of the PE. As a result, Article 13(2) is likely to apply and State PE may therefore be entitled to impose tax on the gain. State PE may also have an obligation to provide relief for tax imposed in State W under the non-discrimination article (Article 24(3)) of the R-PE treaty.\(^\text{1561}\)

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\(^{1559}\) See, for example the reservations of France, Chile, Sweden and Korea in the OECD Commentary to Article 13 of the OECD Model.

\(^{1560}\) Article 13(5) provides that: “Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident.” The other paragraphs of Article 13 deal with capital gains arising from the alienation of immovable property (para 1), capital gains from the alienation of movable property forming part of the business property of a PE (para 2), and capital gains from the alienation of ships or aircraft in international traffic (and associated assets) (para 3).

\(^{1561}\) The PE state’s potential relief obligation under Article 24(3) is discussed in depth in Chapter 4. Article 24(3) requires that the tax imposed on the PE in the PE state be “not less favorably levied” than the tax imposed on a
The recipient’s residence state (State R): State R must apply the conditions of the R-W treaty, the R-L treaty and the R-PE treaty. State R may impose tax but will be obliged to provide relief (either exemption or credit) under both the R-W treaty and the R-PE treaty.

Overview: In this situation, tax may be imposed in State W, State PE and State R. State R will be obliged to provide relief under both the R-W treaty and the R-PE treaty, however may not be able to provide sufficient relief to prevent unrelieved double taxation in the absence of relief in State PE. State PE may also have an obligation to provide relief for tax imposed in State W under the non-discrimination article (Article 24(3)) of the R-PE treaty. In addition, State W and State L are arguably applying the wrong treaty conditions (i.e., the conditions of their treaties with State R) and should instead apply the conditions of their respective treaties with State PE.\textsuperscript{1562}

2.11.2. Application of proposed solutions

The winning residence state of the payor (State W): Instead of applying the R-W treaty, State W must now apply the conditions of the PE-W treaty. However, provided both treaties follow the OECD Model, the application of the two treaties will be the same. That is, for the purposes of this treaty, Article 13(4) will apply and State W will be entitled to impose tax on the gain.

The losing residence state of the payor (State L): Instead of applying the R-L treaty, State L must now apply the conditions of the PE-L treaty. Again, Article 13(4) of the treaty will not apply because the underlying property is not located in State L. Instead, since none of the other paragraphs of Article 13 apply, the capital gain will fall under Article 13(5) and State L will be prevented from imposing tax.

The recipient’s PE state (State PE): State PE must apply the conditions of the R-PE treaty and, as under the existing framework, Article 13(2) is likely to apply and State PE is likely to be entitled to impose tax on the gain. Now, however, State PE must also apply the PE-W treaty and the PE-L treaty and will have a direct obligation to provide relief (exemption or credit) under the terms of the PE-W treaty. State PE will not have any relief obligation under the PE-L treaty since State L is prevented from imposing tax.

The recipient’s residence state (State R): State R must apply the conditions of the R-W treaty, the R-L treaty and the R-PE treaty. State R will continue to have a relief obligation under the R-PE treaty (either exemption or credit) but now, will only have a relief obligation under the R-W treaty if it uses the credit method under the R-PE treaty.\textsuperscript{1563} State R will not have any relief obligation under the R-L treaty because State L is prevented from imposing tax under the terms of the PE-L treaty.

Overview: In this situation, tax may be imposed in the state where the underlying property is located (e.g., State W), the PE state (State PE) and in the residence state of the person deriving the capital gain (State R). Both State R and State PE will have an obligation to provide relief, with State PE now having an explicit relief obligation under the terms of the PE-W treaty. The application of the terms of the treaties concluded between the PE state (State PE) and the source states (State W and State L) has little impact on the ability of each of the states to impose tax provided all the relevant treaties follow the OECD Model. It is possible, however, that the terms of the treaties between the PE state and the source states differ from the terms of the treaties concluded between the residence state (State R) and the source states, in which case the application of the PE states treaties could have a significant impact. The explicit obligation for the PE state to provide relief may also have a significant impact if that state does not provide relief under Article 24(3) of the R-PE treaty. It should also be noted that the residence of the

\textsuperscript{1562} For an in-depth discussion of the appropriate treaty conditions to apply in the source state in PE triangular cases, please refer to Chapter 5.

\textsuperscript{1563} It is proposed that the residence state will have an obligation for tax imposed in the source state(s) in PE triangular cases under a specific provision of its treaties with those states (refer to Section A1.2.1.2., above). The residence state will not have a relief obligation if it is required to exempt the income under its treaty with the PE state or if the source state is prevented from imposing tax under its treaty with the PE state (the PE-S treaty). This proposal is discussed in much greater depth in Chapter 7 (Section 7.5.4.).
payor has no impact on the distribution of taxing rights with respect to capital gains dealt with under Article 13(4) and, as a result, the fact that the dual-resident payor is no longer considered to be resident in State L for the purposes of the R-L treaty will have no impact on the outcome in this case.

2.12. Capital gains from the alienation of other property

Article 13(5) deals with capital gains arising from the alienation of property not dealt with in the other paragraphs of Article 13 (referred to herein as “other property”). It provides that:

“Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident.”

Thus, capital gains from the alienation of other property may only be taxed in the residence state of the person deriving the gain.

This section deals with a situation where a person who is resident in State R derives a capital gain from the alienation of other property, and that gain is attributable to a PE in State PE. The property is purchased by a dual-resident, a person who is resident in two states (State W and State L) for treaty purposes; the payor’s residence is assigned to State W for the purposes of the W-L treaty. This situation is illustrated in the following diagram (in which “HO” denotes head office):

For discussion of typical PE triangular cases involving capital gains from the alienation of other property, refer to Chapter 2 (Section 2.8.5.). For more detailed discussion of reverse dual resident triangular cases, including a brief overview of the outcome in reverse dual-resident triangular cases involving this type of capital gains, refer to Chapter 12 (Section 12.3.).

2.12.1. Existing treaty framework

The winning residence state of the payor (State W): State W must apply the conditions of the R-W treaty. For the purposes of this treaty, Article 13(5) applies and State W will be prevented from imposing tax on the gain.

The losing residence state of the payor (State L): State L must apply the conditions of the R-L treaty. For the purposes of this treaty, Article 13(5) applies and State L will be prevented from imposing tax on the gain.

The recipient’s PE state (State PE): State PE must apply the conditions of the R-PE treaty. For the purposes of the discussion in this section it is assumed that Article 13(5) applies, in which case State PE will be prevented from imposing tax on the capital gain. However, it should be recognised that in many cases where the capital gain is attributable to the PE (and does not arise from the alienation of immovable property), the capital gain will have arisen from the alienation of movable property forming part of the business property of the PE, in which case Article 13(2) would apply and State PE would be entitled to impose tax (refer to Section 2.9, above).

The recipient’s residence state (State R): State R must apply the conditions of the R-W treaty, the R-L treaty and the R-PE treaty. State R may impose tax and will have no obligation to provide relief since State W, State L and State PE are each prevented from imposing tax under their respective treaties with State R.

Overview: In this situation, tax may only be imposed in State R. There will be no need for relief in State PE and no unrelieved double taxation.

2.12.2. Application of proposed solutions
It is not proposed that the benefits of treaties concluded between the PE state and third states should be available in situations where the PE state is prevented from imposing tax under the conditions of the R-PE treaty, as is the case with respect to capital gains from the alienation of ships, aircraft and associated assets. The following discussion is therefore intended to deal only with the impact of the proposed solution for reverse dual-resident triangular cases.

The winning residence state of the payor (State W): State W must continue to apply the conditions of the R-W treaty. For the purposes of this treaty, Article 13(5) applies and State W will be prevented from imposing tax on the gain.

The losing residence state of the payor (State L): State L must continue to apply the conditions of the R-L treaty. For the purposes of this treaty, Article 13(5) applies and State L will be prevented from imposing tax on the gain. Note that the fact that the payor is no longer considered resident in State L for the purposes of the R-L treaty has no impact on the application of that treaty in this case.

The recipient’s PE state (State PE): State PE must continue to apply the conditions of the R-PE treaty. For the purposes of the discussion in this section it is assumed that Article 13(5) applies, in which case State PE will be prevented from imposing tax on the capital gain. However, it should be recognised that in many cases where the capital gain is attributable to the PE, the capital gain will have arisen from the alienation of movable property forming part of the business property of the PE, in which case Article 13(2) would apply and State PE would be entitled to impose tax (refer to Section 2.9, above).

The recipient’s residence state (State R): State R must continue to apply the conditions of the R-W treaty, the R-L treaty and the R-PE treaty. State R may impose tax and will have no obligation to provide relief since State W, State L and State PE are each prevented from imposing tax under their respective treaties with State R.

Overview: The outcome in this situation is the same as under the existing treaty framework. That is, tax may be imposed only in State R (assuming the property is not movable property forming part of the business property of the PE, as mentioned above) and no relief will be required. It should also be noted that the residence of the payor has no impact on the distribution of taxing rights with respect to capital gains dealt with under Article 13(5) and, as a result, the fact that the dual-resident payor is no longer considered to be resident in State L for the purposes of the R-L treaty will have no impact on the outcome in this case.

2.13. Other income

Article 21, titled “other income,” applies to any income not dealt with elsewhere in the treaty. It provides that:

1. Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.

2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein and the right or property in respect of which the income is paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.”

Thus, Article 21 does not allow any taxation of other income outside the residence state unless the income is attributable to a local PE, in which case Article 7 applies.

This section deals with a situation where a resident of State R derives “other income” which is attributable to a PE in State PE. The income is paid by a dual-resident, a person who is resident in two states (State W and State L) for treaty purposes. The payor’s residence is assigned to State W for the purposes of the W-L treaty. This situation is illustrated in the following diagram (in which “HO” denotes head office):

1564 Refer to Chapter 8 (Section 8.6.5.) for further discussion.
For a discussion of typical PE triangular cases involving other income, refer to Chapter 2 (Section 2.9.). For more detailed discussion of reverse dual resident triangular cases, including a brief overview of the outcome in reverse dual-resident triangular cases involving other income, refer to Chapter 12 (Section 12.3.).

2.13.1. Existing treaty framework

**The winning residence state of the payor (State W):** State W must apply the R-W treaty. For the purposes of this treaty Article 21 applies and, since the income is not attributable to a PE in State W, State W is prevented from imposing any tax on the income.

**The losing residence state of the payor (State L):** State L must apply the R-L treaty. For the purposes of this treaty Article 21 applies and, since the income is not attributable to a PE of the recipient in State L, State L is prevented from imposing any tax on the income.

**The recipient’s PE state (State PE):** State PE must apply the conditions of the R-PE treaty. For the purposes of this treaty, the income is attributable to a PE located in State PE and therefore, as a result of Article 21(2), the income will fall under the distributive rule of Article 7. Under Article 7, State PE will be entitled to impose tax on the profit attributable to the PE.

**The recipient’s residence state (State R):** State R must apply the R-W treaty, the R-L treaty and the R-PE treaty. State R may impose tax but will have an obligation to provide relief (either exemption or credit) under the R-PE treaty. State R will not have any relief obligation under the R-W treaty or the R-L treaty since both State W and State L are prevented from imposing any tax on the income.

**Overview:** Tax may be imposed in State R and in State PE, and State R will be obliged to provide relief. Both State W and State L will be prevented from imposing tax on the income. However, State W and State L are nevertheless applying the wrong treaty conditions (i.e., the conditions of their treaties with State R) and should instead apply the conditions of their respective treaties with State PE.1565

2.13.2. Application of proposed solutions

**The winning residence state of the payor (State W):** Instead of applying the conditions of the R-W treaty, State W must now apply the conditions of the PE-W treaty. For the purposes of this treaty, Article 21 will apply and, given that the income is not attributable to a PE in State W, State W will continue to be prevented from imposing any tax on the income.

**The losing residence state of the payor (State L):** Instead of applying the conditions of the R-L treaty, State L must now apply the conditions of the PE-L treaty. For the purposes of this treaty, Article 21 will apply and, given that the income is not attributable to a PE in State L, State L will continue to be prevented from imposing any tax on the income.

**The recipient’s PE state (State PE):** State PE must still apply the conditions of the R-PE treaty, and will still be entitled to impose tax on the profit attributable to the PE in accordance with Article 7 of the treaty. State PE must also apply the PE-W treaty and the PE-L treaty, however since these treaties prevent State

1565 For an in-depth discussion of the appropriate treaty conditions to apply in the source state in PE triangular cases, please refer to Chapter 5.
W and State L (respectively) from imposing any tax on the income, State L will not have any relief obligation.

The recipient’s residence state (State R): State R must continue to apply the R-W treaty, the R-L treaty and the R-PE treaty. State W may impose tax but will be obliged to provide relief in accordance with the terms of the R-PE treaty (either exemption or credit). State R will not have any relief obligation under either the R-W treaty or the R-L treaty, since both State W and State L are prevented from imposing any tax under respective their treaties with State PE.

Overview: In practical terms, the final outcome in this situation is no different after the application of the proposed solutions. That is, State R and State PE may impose tax, with State R obliged to provide relief, and both of the source states are prevented from imposing tax. However, this is a consequence of the assumption that all the relevant treaties follow the OECD Model. The source states are now applying the more appropriate treaty conditions and if terms of the relevant treaties did differ (for example, by not including Article 21), then a very different result could occur. It should also be noted that the residence of the payor has no impact on the distribution of taxing rights with respect to income dealt with under Article 21 and, as a result, the fact that the dual-resident payor is no longer considered to be resident in State L for the purposes of the R-L treaty will have no impact on the outcome in this case.

2.14. Conclusions

This section has discussed a situation where a typical PE triangular case is combined with a reverse dual resident triangular case. The analysis above illustrates that the issues arising in this situation are generally the same as those arising in the basic triangular cases which it comprises. Reverse dual resident triangular cases only give rise to dual source-based taxation in relation to dividends and interest income (and royalties where the applicable treaties differ from the OECD Model) and thus, dual source based taxation may only occur where dividends, interest and royalties are involved. In all other cases, the outcome in this situation under the existing treaty framework is essentially the same as the outcome in a typical dual resident triangular case (outlined in detail in Chapter 2).

The application of the proposed solutions in this case ensures that the source states apply the appropriate treaty conditions, and ensures that both the PE state and the residence state of the person receiving the income provide appropriate relief to prevent unrelieved double taxation. Importantly, the provisions of the treaties concluded between the PE state and the source states do not apply in situations where the PE state is prevented from imposing tax on the income under its treaty with the residence state. In such cases, the source states continue to apply the conditions of their respective treaties with the residence state.

This situation has also demonstrated the application of the proposed solution for reverse dual resident triangular cases. Under this proposed solution, a dual resident person would not be considered resident in the “losing” residence state for the purpose of treaties between that state and third states. As a result, any payments made by the dual resident are not considered to be paid by a resident of the losing residence state for the purposes of those treaties. This will only have an impact, however, in relation to categories of income for which there are distributive rules based on the residence of the payor, i.e., dividends, interest and royalties. With respect to other categories of income the residence (or non-residence) of the payor is generally irrelevant for the purposes of determining whether a particular state can impose source-based taxation. Thus, in most reverse dual resident triangular cases, the modification of the residence rules will have no impact on the application of the relevant treaties.

The analysis in this section has also demonstrated the interaction between the proposed solutions for PE triangular cases and for reverse dual resident triangular cases. As can be seen above, this causes no special issues. The source states (the residence states of the dual resident) will apply the conditions of their respective treaties with the PE state of the recipient and the dual resident will simply not be considered resident in the losing residence state for the purposes of applying the treaty between that state and the PE state.