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

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Section III: Dual resident triangular cases combined with reverse PE triangular cases

3.1. Introduction

The case discussed in this section is a combination of a dual resident triangular case\textsuperscript{1566} and a reverse PE triangular case.\textsuperscript{1567} It involves a person who is resident in two states ("State W" and "State L") under their respective domestic laws and for treaty purposes who derives income from outside those two states. The income is paid by a resident of a third state ("State R") and the payment originates from a PE which the payor has in a fourth state ("State PE"); these two states are collectively referred to as the "source states." This case is illustrated in the following diagram (in which "HO" denotes head office):

\begin{center}
\begin{tikzpicture}
  \node [state,align=center] (STATE_W) at (1,0) {State W\hspace{1cm} STATE_L
  \node [state,align=center] (STATE_R) at (5,0) {HO
  \node [state] (STATE_PE) at (2.5,-2) {PE\hspace{1cm} State PE
  \draw [->,thick] (STATE_W) -- (STATE_R);
  \draw [->,thick] (STATE_R) -- (STATE_W);
  \draw [->,thick] (STATE_W) -- (STATE_PE);
  \draw [->,thick] (STATE_R) -- (STATE_PE);
\end{tikzpicture}
\end{center}

For the purposes of the analysis in this section, it is assumed that the tie-breaker rule of the treaty between the two residence states of the person deriving the income assigns that 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 state to which residence is not assigned is referred to as the losing residence state ("State L"). It is also assumed that the dual-resident person does not have a PE in the losing residence state.\textsuperscript{1568}

For the purposes of this analysis, it is also assumed that the allocation of residence under the tie-breaker provision of the treaty between the two residence states of the person deriving the income is not effective for the purposes of treaties concluded between State L and third states. This means that any amount received by the dual resident will continue to be considered to be received by a resident of State L for the purposes of such treaties. This position 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.\textsuperscript{1569}

3.1.1. The existing treaty framework

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

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

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\begin{itemize}
  \item \textsuperscript{1566} For a detailed overview of the application of tax treaties in dual resident triangular cases, refer to Chapter 9.
  \item \textsuperscript{1567} For a detailed discussion of reverse PE triangular cases, refer to Chapter 12 (Section 12.2.).
  \item \textsuperscript{1568} For discussion of the impact of a dual resident having a PE in the losing residence state in a dual resident triangular case, refer to Chapter 9 (Section 9.4.3.).
  \item \textsuperscript{1569} 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 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.).
\end{itemize}
(ii) the treaty between the losing residence state of the recipient and the residence state of the payor (the L-R treaty);

(iii) the treaty between the winning residence state of the recipient and the PE state of the payor (the W-PE treaty);

(iv) the treaty between the losing residence state of the recipient and the PE state of the payor (the L-PE treaty); and

(v) the treaty between the winning and losing residence states of the recipient (the W-L treaty).

The treaty between the payor’s residence state and the payor’s PE state (the R-PE treaty) will not apply because for the purposes this treaty, the income is not received by a resident of one of the contracting states.

3.1.2. Application of proposed solutions

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

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 receiving income from third states, this would mean that the dual-resident could no longer claim the benefit of treaties concluded between its losing residence state and the state (or states) where income arises. As a result, source states would no longer be subject to multiple treaty conditions in respect of income derived by a dual-resident.

For the purposes of the discussion in this appendix, it is assumed that the dual-resident does not have a PE in the losing residence state. One consequence of this is that the losing residence state will generally be prevented from imposing tax on the income. If there is a PE in the losing residence state then that state would be entitled to impose tax on a number of categories of income to the extent that they are attributable to the PE; in this case relief would be required in that state. This could be achieved by implementing the extension of treaty benefits to PEs as outlined briefly above. For the purposes of the discussion below, however, there will generally be no relief required in the losing residence state.

Limits on source-based taxation where payments originate from a PE

It is proposed that interest (and, where applicable, royalties) which originate from a PE located in a third state should not be considered to arise in the payor’s residence state for the purposes of treaties concluded between that state and third states. This would be achieved by changing the wording of Article

1570 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.).
1571 This proposed provision is extracted from Chapter 11 (Section 11.3.2.) where it is discussed in-depth.
1572 For an analysis of the outcome of dual resident triangular cases involving various categories of income (in situations where there is no PE in the losing residence state) refer to Chapter 9 (Sections 9.4.1. and 9.4.2.).
1573 For a discussion of situations where the dual resident does have a PE in the losing residence state, refer to Chapter 9 (Section 9.4.3.). In such cases, the losing state may impose tax on certain categories of income attributable to the PE and the situation becomes similar to a typical PE triangular case.
1574 For a brief overview of this proposal, see Section A1.2.1. above. This proposal is discussed in detail throughout Chapter 7 and Chapter 8.
Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a State other than that of which he is a resident 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.  

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As a result the residence state of the payor in a reverse PE triangular case would be prevented from imposing tax. This may be subject to certain conditions, for example that the PE state imposes source-based tax on the interest, but it is assumed that any such conditions are satisfied for the purposes of the discussion below.

Applicable treaties

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

(i) the treaty between the winning residence state of the recipient and the residence state of the payor (the W-R treaty);
(ii) the treaty between the winning residence state of the recipient and the PE state of the payor (the W-PE treaty); and
(iii) the treaty between the winning and losing residence states of the recipient (the W-L treaty).

The treaty between the payor's residence state and the payor's PE state (the R-PE treaty) will not apply because for the purposes this treaty, the income is not received by a resident of one of the contracting states. In addition, as a result of the person receiving the income no longer being resident in State L for treaty purposes, the L-R treaty and the L-PE treaty will no longer apply.

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.

3.2. 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.  

1577 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

1575 This provision has been taken from the 2010 OECD Commentary on Article 11, para. 30. It is discussed in much greater depth in Chapter 12 (Section 12.2.2.).

1576 Refer to Chapter 12 (Section 12.2.2.2.) for discussion of the reasons for imposing such limitations and the type of limitations that may be imposed.

1577 The term “permanent establishment” is defined in Article 5.
the functions performed, assets used and risks assumed by the enterprise through the
permanent establishment and through the other parts of the enterprise.\footnote{1578}

Thus, the source state may not impose any tax on business profits except to the extent they are
attributable to a PE. 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 dual resident person, resident in State W and in State L,
derives business profits from outside those two states. The income is paid by a resident of State R and
originates from a PE of the payor located in State PE. The residence of the dual resident person is
assigned to State W for the purposes of the treaty between the two residence states. This situation is
illustrated in the following diagram (in which “HO” denotes head office):

For a more detailed discussion of dual resident triangular cases, refer to Chapter 9 (in particular, Section
9.4.). For more detailed discussion of reverse PE triangular cases, including a brief overview of the
outcome in reverse PE triangular cases involving business profits, refer to Chapter 12 (Section 12.2.).

3.2.1. Existing treaty framework

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

The payor’s PE state (State PE): State PE must apply the conditions of both the W-PE treaty and the L-PE
treaty. For the purposes of both these treaties, Article 7 will apply and, given that the income is not
attributable to a PE of the recipient in State PE, State PE will be prevented from imposing tax.

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

The winning residence state (State W): State W must apply the conditions of the W-R treaty, the W-PE treaty
and the W-L treaty. State W may impose tax on the income and, since State R, State PE and State L are
all prevented from imposing tax, State W will have no obligation to provide relief.

Overview: Under the existing treaty framework, tax may only be imposed in State W and there will be no
unrelieved double taxation. This situation is effectively the same as a dual-resident triangular case
involving business profits, since both source states are prevented from imposing tax. The main concern
in this situation is the application of multiple treaty conditions in the source states. This does not have
any practical impact in situations where both applicable treaties follow the OECD Model, but in some
cases it could influence whether State R is entitled to impose tax, e.g., if the PE definitions differ between
the two treaties and the person deriving the income would have a PE in the source state for the purposes
of one of the applicable treaties but not for the purposes of the other.

3.2.2. Application of proposed solutions

The payor’s residence state (State R): State R must continue to apply the conditions of the W-R treaty but does
not have to apply the L-R treaty. For the purposes of the W-R treaty, Article 7 will apply and State R will
be prevented from imposing tax on the income. This is the same outcome as under the existing treaty

\footnote{1578} Article 7, paragraphs 1 and 2.
framework, however, the outcome could be different if there is a difference between the terms of the W-R treaty and the L-R treaty.

The payor's PE state (State PE): State PE must continue to apply the conditions of the W-PE treaty but does not have to apply the L-PE treaty. For the purposes of the W-PE treaty, Article 7 will apply and State PE will be prevented from imposing tax on the income. This is the same outcome as under the existing treaty framework, however, the outcome could be different if there is a difference between the terms of the W-PE treaty and the L-PE treaty.

The losing residence state (State L): State L must continue to apply the conditions of the W-L treaty. For the purposes of this treaty, Article 7 will apply and State L will be prevented from imposing tax on the income.

The winning residence state (State W): State W must continue to apply the W-R treaty, the W-PE treaty and the W-L treaty. State W may impose tax on the income and, since all the other states are prevented from imposing tax, State W will have no obligation to provide relief.

Overview: The proposed solutions would generally have little practical impact in this situation, since the distributive rules for business profits do not generally differ between treaties. One situation where a different outcome may arise is where the PE definition contained in a source states' (State R and State PE) treaties with State W differ from those contained in their treaties with State L. If this occurs, one of the source states may be entitled to impose tax if it applies the conditions of its treaty with State W but not if it applies the conditions of its treaty with State L or vice versa. Note that the proposals relating to reverse PE triangular cases do not apply here, since those proposals deal only with situations involving interest and royalties.

3.3. 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. 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.

This section deals with a situation where a dual resident person, resident in State W and in State L, receives dividends from outside those two states. The dividends are paid by a resident of State R and are...

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\(^{1579}\) 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.).
paid out of profits which are attributable to a PE of the payor located in State PE. The residence of the
dual resident person is assigned to State W for the purposes of the treaty between the two residence
states. This situation is illustrated in the following diagram (in which “HO” denotes head office):

For a more detailed discussion of dual resident triangular cases, refer to Chapter 9 (in particular, Section
9.4.). For a detailed discussion of reverse PE triangular cases involving dividends, refer to Chapter 12
(Section 12.2.1.).

3.3.1. Existing treaty framework

The payor’s residence state (State R): State R must apply the conditions of both the W-R treaty and the L-R
treaty. For the purposes of both these treaties, Article 10 will apply and State R will be entitled to impose
a limited rate of tax on the dividends. If the applicable rate differs between the two treaties, State R can
only satisfy its treaty obligations by applying the lower of the two rates.1580

The payor’s PE state (State PE): State PE must apply the conditions of both the W-PE treaty and the L-PE
treaty. For the purposes of both these treaties, Article 10 will not apply because the dividends are not
paid by a resident of State PE. Instead, Article 7 or Article 21 will apply (depending on whether the
income is considered to be business profits) and State PE will be prevented from imposing tax on the
dividends. State PE may also be prevented from imposing tax under Article 10(5) of the R-PE treaty.1581

The losing residence state (State L): State L must apply the conditions of the W-L treaty. Article 10 will not
apply because the dividends are not paid by a resident of State L. Instead, Article 7 or Article 21 will
apply, depending on whether the dividends are considered to be business profits, and regardless of which
of these two articles applies State L will be prevented from imposing any tax on the dividends.

The winning residence state (State W): State W must apply the conditions of the W-R treaty, the W-PE treaty
and the W-L treaty. State W may impose tax but will be obliged to provide relief (using the credit

pp. 298-301; Avery Jones, J.F., and Bobbett, C., ”Triangular Treaty Problems: A Summary of the Discussion in
European Taxation 1, (2005), pp. 2-13;
1581 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 PE state from imposing tax on the dividends. The main problem
with applying this provision is that it applies under the treaty between the residence state and the PE state 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. Article 10(5) is discussed in detail in Chapter 12 (see Section 12.2.1. and Section 12.3.4.).
method) for tax imposed in State R. State W will not be obliged to provide any relief under the W-PE treaty or the W-L treaty, since both State PE and State L are prevented from imposing tax. There will be no unrelieved double taxation.

Overview: In this situation, tax may be imposed in State R and State W, and State W will have an obligation to provide relief (using the credit method) for tax imposed in State R. The main issue in this situation is the application of multiple treaty conditions in State R and the potential for improper use of the L-R treaty, particularly given that State L is prevented from imposing any tax on the dividends under the W-L treaty.

3.3.2. Application of proposed solutions

The payor’s residence state (State R): State R must continue to apply the conditions of the W-R treaty but no longer has to apply the L-R treaty. For the purposes of the W-R treaty, Article 10 will apply and State R will be entitled to impose a limited rate of tax on the dividends. State R is no longer required to apply multiple treaty conditions in relation to the dividends.

The payor’s PE state (State PE): State PE must continue to apply the conditions of the W-PE treaty but no longer has to apply the L-PE treaty. Article 10 of the W-PE treaty will not apply because the dividends are not paid by a resident of State PE. Instead, either Article 7 or Article 21 will apply and State PE will be prevented from imposing any tax on the dividends. If State PE is prevented from imposing tax as a result of Article 10(5) of the R-PE 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 PE from imposing tax). However, there is some uncertainty regarding the application of Article 10(5) in this situation and preventing State PE from imposing tax under the terms of the W-PE treaty makes the outcome clearer and more certain.

The losing residence state (State L): State L must continue to apply the W-L treaty. For the purposes of this treaty, Article 10 does not apply since the dividends are not paid by a resident of State L. Instead, Article 7 or Article 10 will apply, depending on whether the income is considered to be business profits, and State L will be prevented from imposing tax on the income.

The winning residence state (State W): State W must continue to apply the W-R treaty, the W-PE treaty and the W-L treaty. State W may impose tax but is obliged to provide relief (using the credit method) for tax imposed in State R. State W will not be obliged to provide relief under the W-PE treaty or the W-L treaty, since both State PE and State L are prevented from imposing tax.

Overview: The source states will now be subject only to the conditions of their respective treaties with State W and will no longer be obliged to apply their treaties with State L. This means they are no longer subject to multiple treaty conditions in respect of the same income and addresses the risk of improper use of the treaties between the losing residence state and the source states. State PE will generally be prevented from imposing tax regardless of which treaty it applies. In State R, however, the treaty with State L may provide a lower maximum level of source-based taxation of dividends than the treaty with State W, in which case the application of the L-R treaty would have an impact on the amount of tax that State R could impose. Note that the proposals relating to reverse PE triangular cases do not apply here, since those proposals deal only with situations involving interest and royalties.

3.4. Interest

Interest is dealt with in Article 11, which allows the state where interest arises to impose a tax at a limited rate. 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.\footnote{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 is paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.”}

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. It should be noted that where interest is paid by a resident of a contracting state for the purposes of a particular treaty and is borne by a PE, but that PE is not located in either of the contracting states, then the interest will continue to arise in the residence state of the payor for the purposes of Article 11.\footnote{See, inter alia, the 2010 OECD Commentary on Article 11, paras. 28 and 29. This is discussed in much greater depth in Chapter 12 (Section 12.2.2.1.).} Thus, the interest will arise in the residence state of the payor for the purposes of the treaty between that state and the residence state of the recipient, and will arise in the PE state of the payor for the purposes of the treaty between that state and the residence state of the recipient. As will be seen below, this may give rise to dual source-based taxation in reverse PE triangular cases.\footnote{This is discussed in much greater depth in Chapter 12 (Section 12.2.2.1.).}

This section deals with a situation where a dual resident person, resident in State W and in State L, receives interest income from outside those two states. The interest is paid by a resident of State R and is borne by a PE of the payor located in State PE. The residence of the dual resident person is assigned to State W for the purposes of the treaty between the two residence states. This situation is illustrated in the following diagram (in which “HO” denotes head office):

For a more detailed discussion of dual resident triangular cases, refer to Chapter 9 (Section 9.4.). For a detailed discussion of reverse PE triangular cases involving interest, refer to Chapter 12 (Section 12.2.2.).

3.4.1. Existing treaty framework

The payor’s residence state (State R): State R must apply the conditions of the W-R treaty and the L-R treaty. Under Article 11(5) of both these treaties, the interest will be considered to arise in State R since it is paid by a resident of that state, despite the fact that the interest is borne by a PE of the payor located in a third state (i.e., State PE). Article 11 will therefore apply for the purposes of both treaties and State R will be
entitled to impose a limited rate of tax on the interest. If the applicable rates differ between the two treaties, State R can only satisfy its treaty obligations by applying the lower of the two rates.\textsuperscript{1585}

The payor’s PE state (State PE): State PE must apply the conditions of the W-PE treaty and the L-PE treaty. Under Article 11(5) of both these treaties, the interest will be considered to arise in State PE since it is borne by a PE of the payor located in that state. Article 11 will therefore apply and State PE will be entitled to impose a limited rate of tax on the interest. If the applicable rate differs between the two treaties, State PE can only satisfy its treaty obligations by applying the lower of the two rates.\textsuperscript{1586}

The losing residence state (State L): State L must apply the conditions of the W-L treaty. Article 11 will not apply for the purposes of the W-L treaty since the interest is not paid by a resident of State L. Instead, Article 7 or Article 21 will apply, depending on whether the income is considered to be business profits, and since the income is not attributable to a PE in State L, State L will be prevented from imposing tax.

The winning residence state (State W): State W must apply the W-R treaty, the W-PE treaty and the W-L treaty. State W may impose tax, but will be required to grant relief under both the W-R treaty and the W-PE treaty. This would generally be credit relief regardless of the general method of relief under those treaties. Given that State W has an obligation to provide relief for tax imposed in two states, it may not be able to provide sufficient relief to prevent unrelieved double taxation.\textsuperscript{1587}

Overview: In this situation, source-based taxation may be imposed in both State R and State PE. For the purposes of State R’s treaties with State W and State L, the interest is considered to arise in State R and for the purposes of State PE’s treaties with State W and State L, the interest is considered to arise in State PE. Both State R and State PE may therefore impose tax on the interest under Article 11 of their respective treaties with the two residence states of the person deriving the income. State W will be obliged to provide relief, but may not be able to provide sufficient relief to prevent double taxation. In addition, both State R and State PE are subject to multiple treaty conditions in respect of the same income. This may give rise to concerns about the potential for improper use of the treaties concluded between State L and the source states (e.g., where the rate of tax allowed under a particular state’s treaty with State L is lower than the rate allowed under its treaty with State W). This is of particular concern in situations (like the current one) where State L is prevented from imposing any tax on the interest by the conditions of the W-L treaty.

\textbf{3.4.2. Application of proposed solutions}

The payor’s residence state (State R): State R must continue to apply the conditions of the W-R treaty but no longer has to apply the L-R treaty. In addition, Article 11(5) would be modified such that where interest income is borne by a PE in a third state (in this case, State PE), the interest would not be considered to


\textsuperscript{1587} Refer to Chapter 3 (Section 3.2.) for an analysis of the residence states capacity to provide sufficient relief to prevent unrelieved double taxation where source based taxation has been imposed in more than one state; Chapter 3 discusses this in the context of PE triangular cases, but it is equally relevant in dual resident triangular cases. Broadly, the ability to grant sufficient relief will depend on the relative tax rates in the states involved and, where the state granting relief uses the credit method, will also depend on the applicable credit limitations.
arise in the residence state of the payor. As a result, the interest would not be considered to arise in State R for the purposes of the W-R treaty and Article 11 would not apply. Instead Article 7 or Article 21 would apply, depending on whether the income is considered to be business profits, and State R would be prevented from imposing tax on the income.

The payor's PE state (State PE): State PE must continue to apply the conditions of the W-PE treaty but no longer has to apply the L-PE treaty. Under the modified version of Article 11(5) (as under the current version) the interest would be considered to arise in State PE for the purposes of the W-PE treaty. Article 11 of the treaty would therefore apply and State PE would be entitled to impose a limited rate of tax on the gross amount of the interest.

The losing residence state (State L): State L must continue to apply the W-L treaty. Article 11 will not apply for the purposes of the W-L treaty since the interest is not paid by a resident of State L. Instead, Article 7 or Article 21 will apply, depending on whether the income is considered to be business profits, and since the income is not attributable to a PE in State L, State L will be prevented from imposing tax.

The winning residence state (State W): State W must continue to apply the W-R treaty, the W-PE treaty and the W-L treaty. State W may impose tax but is obliged to provide relief (using the credit method) for tax imposed in State PE. State W will not be obliged to provide relief under the W-R treaty or the W-L treaty, since both State R and State L are prevented from imposing tax.

Overview: The source states will now be subject only to the conditions of their respective treaties with State W and will no longer be obliged to apply their treaties with State L. This means they are no longer subject to multiple treaty conditions in respect of the same income and addresses the risk of improper use of the treaties between the losing residence state and the source states. In addition, the proposed modifications to Article 11(5) ensures that the interest is only considered to arise in one state for treaty purposes (i.e., State PE) and thus is no longer subject to dual source-based taxation.

3.5. 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.

1588 As mentioned above, it is proposed that interest (and, where applicable, royalties) which originate from a PE located in a third state should not be considered to arise in the payor's residence state for the purposes of treaties concluded between that state and third states. This would generally result in the PE state (but not the residence state) of the payor being entitled to impose source based taxation on such payments. It would be achieved by changing the wording of Article 11(5) and, where applicable, the corresponding provision of Article 12. Refer to Section 3.1.2., above, and to Chapter 12 (Section 12.2.2.) for an in-depth discussion of this proposal.

1589 Note that it is assumed that any conditions attached to the limitation on State R’s taxing rights are satisfied, e.g., there may be a provision to the effect that the income continues to arise in the residence state of the payor for the purposes of Article 11 if the PE state does not impose any tax on the payment. For further discussion of the conditions that may be attached, refer to Chapter 12 (Section 12.2.2.2.).

1590 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
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 exactly the same as that outlined for interest above. The analysis below briefly considers both situations where the applicable treaties do allow source based taxation of royalties under Article 12 and situations where they do not. Where source-based taxation of royalties is allowed, it is assumed that the relevant treaty contains a provision mirroring Article 11(5) for determining whether royalties arise in a particular state. Where Article 12 does not allow source based taxation of royalties, the place where royalties arise becomes less important because if the royalties are not considered to arise in a particular state, then that state will nevertheless generally be prevented from imposing tax under either Article 7 or Article 21 of the treaty (depending on whether the income is considered to be business profits). The result will therefore be the same regardless of whether the royalties are or are not considered to arise in the state applying the treaty.

This section deals with a situation where a dual resident person, resident in State W and in State L, receives royalties from outside those two states. The royalties are paid by a resident of State R and originate from a PE of the payor located in State PE. The residence of the dual resident person is assigned to State W for the purposes of the treaty between the two residence states. This situation is illustrated in the following diagram (in which “HO” denotes head office):

For a more detailed discussion of dual resident triangular cases, refer to Chapter 9 (Section 9.4.). For discussion of reverse PE triangular cases involving royalties, refer to Chapter 12 (Section 12.2.2.).

### 3.5.1. Existing treaty framework

The payor's residence state (State R): State R must apply the conditions of the W-R treaty and the L-R treaty. For the purposes of applying these treaties the income would generally be considered to arise in State R, in which case Article 12 would apply. Depending on the terms of Article 12, State R will either be prevented from imposing tax (if one or both of the treaties follows the OECD Model) or will be entitled to impose tax on the royalties at a limited rate. If the applicable rates differ between the two treaties, State R can only satisfy its treaty obligations by applying the lower of the two rates.

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."


1592 This assumes that the royalties are considered to arise in State R for the purposes of the treaty, i.e., as a result of being paid by a resident of State R. 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 R, State R 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).

**The payor's PE state (State PE):** State PE must apply the conditions of the W-PE treaty and the L-PE treaty. For the purposes of applying these treaties the income would generally be considered to arise in State PE, in which case Article 12 would apply. If Article 12 of either of the two treaties does not allow any source based taxation, State PE will be prevented from imposing tax. If both treaties do allow source-based taxation under Article 12 then State PE would be entitled to impose tax at a limited rate. If the applicable rates differ between the two treaties, State PE can only satisfy its treaty obligations by applying the lower of the two rates.

**The losing residence state (State L):** State L must apply the conditions of the W-L treaty. Article 12 will not apply for the purposes of the W-L treaty since the royalties would not generally be considered to arise in State L. Instead, Article 7 or Article 21 will apply, depending on whether the income is considered to be business profits, and since the income is not attributable to a PE in State L, State L will be prevented from imposing tax.

**The winning residence state (State W):** State W must apply the W-R treaty, the W-PE treaty and the W-L treaty. State W may impose tax, but to the extent that State R or State PE or both of these states may also impose tax, State W will be required to grant relief. This would generally be credit relief, regardless of the general method of relief under those treaties. Given that State W has an obligation to provide relief for tax imposed in two states, it may not be able to provide sufficient relief to prevent unrelieved double taxation.

**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 tax is imposed in State R, in State PE, in both of these states or in neither of them. State W will be obliged to provide relief, but may not be able to provide sufficient relief to prevent double taxation. An important issue in this situation is that both State R and State PE are subject to multiple treaty conditions in respect of the same income. This may give rise to concerns about the potential for improper use of the L-R treaty, particularly given that State L is prevented from imposing any tax on the royalties by the conditions of the W-L treaty.

### 3.5.2. Application of proposed solutions

**The payor's residence state (State R):** State R must continue to apply the conditions of the W-R treaty but no longer has to apply the L-R treaty. In general, Article 12 could be expected to apply for the purposes of the W-R treaty on the basis that they royalties arise in State R. However, if Article 12 of the W-R treaty allows source-based taxation, it would be modified to the effect that where royalties are borne by a PE in a third state (in this case, State PE), those royalties would not be considered to arise in the residence state of the payor (State R). As a result, the royalties would not be considered to arise in State R for the

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1594 This assumes that the royalties are considered to arise in State PE for the purposes of both of the applicable treaties, i.e., as a result of originating from a PE located in State PE. 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 PE2, State PE2 would 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).


1596 Refer to Chapter 3 (Section 3.2.) for an analysis of the residence states capacity to provide sufficient relief to prevent unrelieved double taxation where source based taxation has been imposed in more than one state; Chapter 3 discusses this in the context of PE triangular cases, but it is equally relevant in dual resident triangular cases. Broadly, the ability to grant sufficient relief will depend on the relative tax rates in the states involved and, where the state granting relief uses the credit method, will also depend on the applicable credit limitations.

1597 As mentioned above, it is proposed that interest (and, where applicable, royalties) which originate from a PE located in a third state should not be considered to arise in the payor's residence state for the purposes of treaties.
purposes of the W-R treaty and Article 12 would not apply. Instead Article 7 or Article 21 would apply, depending on whether the income is considered to be business profits, and State R would be prevented from imposing tax. If Article 12 does not allow source based taxation of royalties, then the royalties may still be considered to arise in State R (i.e., Article 12 may not be modified), but in that case Article 12 would prevent State R from imposing tax and thus the overall result would be the same.

**The payor’s PE state (State PE):** State PE must continue to apply the conditions of the W-PE treaty but no longer has to apply the L-PE treaty. For the purposes of this treaty, the royalties would generally be considered to arise in State PE and Article 12 would apply. Depending on the terms of the treaty, State PE may be either prevented from imposing tax or may be entitled to impose tax at a limited rate.

**The losing residence state (State L):** State L must continue to apply the W-L treaty. Article 12 would not apply for the purposes of the W-L treaty since the royalties do not arise in State L. Instead, Article 7 or Article 21 would apply, depending on whether the income is considered to be business profits, and since the income is not attributable to a PE in State L, State L will be prevented from imposing tax.

**The winning residence state (State W):** State W must continue to apply the W-R treaty, the W-PE treaty and the W-L treaty. State W may impose tax but if State PE may also impose tax (under the W-PE treaty), then State W will be obliged to provide relief (using the credit method) for tax imposed in State PE. State W will not be obliged to provide relief under the W-R treaty or the W-L treaty, since both State R and State L are prevented from imposing tax.

**Overview:** The source states will now be subject only to the conditions of their respective treaties with State W and will no longer be obliged to apply their treaties with State L. This means they are no longer subject to multiple treaty conditions in respect of the same income and addresses the risk of improper use of the treaties between the losing residence state and the source states. In addition, the proposed modification to Article 12 will ensure that the royalties will only be considered to arise, and thus may only be taxable, in one of the source states (State PE). Depending on the terms of Article 12 of the W-PE treaty, State PE may be prevented from imposing tax or may be entitled to impose tax at a limited rate. State R will be prevented from imposing any source-based taxation on the royalties.

### 3.6. 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.

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1598 Note that it is assumed that any conditions attached to the limitation on State R’s taxing rights are satisfied, e.g., there may be a provision to the effect that the income continues to arise in the residence state of the payor for the purposes of Article 12 if the PE state does not impose any tax on the payment. For further discussion of the conditions that may be attached, refer to Chapter 12 (Section 12.2.2.2).

1599 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. 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 dual resident person, resident in State W and in State L, receives income from immovable property located outside those two states. That person’s residence is assigned to State W for the purposes of the treaty between the two residence states. The income is paid by a resident of State R and originates from a PE of the payor located in State PE. 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 the PE state of the payor (State PE); this may occur, for example, where the payor leases business premises in that state through which it carries on its enterprise, thus giving rise to the PE in that state. This situation is illustrated in the following diagram (in which “HO” denotes head office):

For a more detailed discussion of dual resident triangular cases, refer to Chapter 9 (Section 9.4.). For discussion of reverse PE triangular cases and an overview of the outcome of cases involving income from immovable property, refer to Chapter 12 (particularly Section 12.2.3.).

3.6.1. Existing treaty framework

The payor’s residence state (State R): State R must apply the conditions of both the W-R treaty and the L-R treaty. For the purposes of both these treaties, Article 6 will not apply because the immovable property is not located in State R. Instead, Article 7 or Article 21 applies (depending on whether the income is considered to be business profits) and State R is prevented from imposing tax on the income.

The payor’s PE state (State PE): State PE must apply the conditions of both the W-PE treaty and the L-PE treaty. For the purposes of both these treaties, Article 6 will apply and, given that the immovable property is located in State PE, State PE will be entitled to impose tax on the income.

The losing residence state (State L): State L must apply the conditions of the W-L treaty. For the purposes of this treaty Article 6 will not apply because the immovable property is not located in State L. Instead, Article 7 or Article 21 applies (depending on whether the income is considered to be business profits) and State L will be prevented from imposing tax on the income.

The winning residence state (State W): State W must apply the W-R treaty, the W-PE treaty and the W-L treaty. State W may impose tax but will have an obligation to provide relief (either exemption or credit)

under the W-PE treaty. State W will not have a relief obligation under either the W-R treaty or the W-L treaty because the terms of those treaties do not allow State R or State L, respectively, to impose any tax on the income.

Overview: In this situation, tax is imposed in the state where the property is located (State PE) and in State W and State W will have an obligation to provide relief. State R and State PE are both subject to multiple treaty conditions in respect of the same income, however this is unlikely to have any practical impact in relation to income from immovable property; State R (the state where the property is located) would generally be entitled to impose tax under both treaties and State PE would generally be prevented from imposing tax under both treaties. This is particularly so given that the definition of immovable property in Article 6 primarily refers to the domestic law of the state where the property is located. Nevertheless, there may be situations where the terms of the two applicable treaties differ in a way that impacts on one of the source states’ taxing rights.

3.6.2. Application of proposed solutions

The payor’s residence state (State R): State R must continue to apply the conditions of the W-R treaty but no longer has to apply the L-R treaty. This is unlikely to have any practical impact, however, since State R will continue to be prevented from imposing tax under either Article 7 or Article 21 of the W-R treaty. Article 6 will not apply because the immovable property is not located in State R.

The payor’s PE state (State PE): State PE must continue to apply the conditions of the W-PE treaty but no longer has to apply the L-PE treaty. Article 6 will continue to apply for the purposes of the W-PE treaty and State PE will be entitled to impose tax on the income.

The losing residence state (State L): State L will continue to apply the W-L treaty. Article 6 of the treaty will not apply because the immovable property is not located in State L. Instead, Article 7 or Article 21 will apply (depending on whether the income is considered to be business profits) and State L will be prevented from imposing tax on the income.

The winning residence state (State W): State W must continue to apply the W-R treaty, the W-PE treaty and the W-L treaty. State W may impose tax but will be obliged to provide relief (either credit or exemption) under the W-PE treaty. State W will not be obliged to provide relief under the W-R treaty or the W-L treaty, since both State R and State L are prevented from imposing tax.

Overview: The source states will now be subject only to the conditions of their respective treaties with State W and will no longer be obliged to apply their treaties with State L. This means they are no longer subject to multiple treaty conditions in respect of the same income and addresses the risk of improper use of the treaties between the losing residence state and the source states. Note that the proposals relating to reverse PE triangular cases do not apply here, since those proposals deal only with situations involving interest and royalties.

3.7. 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.\textsuperscript{1601}

This section deals with a situation where a dual resident person, resident in State W and in State L, receives income from shipping, inland waterways transport and/or air transport from outside those two states. The income is paid by a resident of State R and originates from a PE of the payor located in State PE. The place of effective management of the person deriving the income is located in State W, and that person’s residence is assigned to State W for the purposes of the treaty between the two residence states. 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):

For a more detailed discussion of dual resident triangular cases, refer to Chapter 9 (Section 9.4.). For further discussion of reverse PE triangular cases and a brief overview of a reverse PE triangular situation involving income covered by Article 8, refer to Chapter 12 (Section 12.2.3.).

3.7.1. Existing treaty framework

The payor’s residence state (State R): State R must apply the conditions of both the W-R treaty and the L-R treaty. For the purposes of both these treaties, Article 8 will apply and the income may only be taxed in the state where the place of effective management is located. For the purposes of the W-R treaty, it is quite clear that, since the place of effective management is located in State W, State R will be prevented from imposing tax on the income. For the purposes of the L-R treaty, however, the place of effective management is located in a third state and it is thus unclear how Article 8 should be applied. In any case, this will not have any practical impact since State R is already prevented from imposing tax under the W-R treaty.

The payor’s PE state (State PE): State PE must apply the conditions of both the W-PE treaty and the L-PE treaty. For the purposes of both these treaties, Article 8 will apply and the income may only be taxed in the state where the place of effective management is located. For the purposes of the W-PE treaty, it is quite clear that, since the place of effective management is located in State W, State PE will be prevented from imposing tax on the income. For the purposes of the L-PE treaty, however, the place of effective management is located in a third state and it is thus unclear how Article 8 should be applied.\textsuperscript{1602} In any case, this will not have any practical impact since State PE is already prevented from imposing tax under the W-PE treaty.

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

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

\textsuperscript{1601} The place of effective management will generally be in the residence state of the enterprise, and this is assumed to be the case 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.).

\textsuperscript{1602} This is discussed further in Chapter 2 (see Section 2.7.).
Overview: In this situation, tax may only be imposed in State W. All the other states involved will be prevented from imposing tax under Article 8 of their respective treaties with State W. One issue which arises in this situation is that the source states, State R and State PE, will be bound by multiple treaty conditions in respect of the income (i.e., their respective treaties with both State W and State L). This is unlikely to have any practical impact in most cases, but it could alter the source states’ ability to impose tax if the relevant conditions of the two treaties differ. It is also unclear how Article 8 of the treaties between State L and the source states should be applied, given that the place of effective management of the person deriving the income is located outside the contracting states.

3.7.2. Application of proposed solutions

The payor’s residence state (State R): State R must continue to apply the conditions of the W-R treaty but no longer has to apply the L-R treaty. This is unlikely to have any practical impact, however, since Article 8 of the W-R treaty will continue to prevent State R from imposing any tax.

The payor’s PE state (State PE): State PE must continue to apply the conditions of the W-PE treaty but no longer has to apply the L-PE treaty. Again, this is unlikely to have any practical impact since Article 8 of the W-PE treaty will continue to prevent State PE from imposing any tax.

The losing residence state (State L): State L will continue to apply the W-L treaty. For the purposes of this treaty, Article 8 will apply and State L will be prevented from imposing any tax on the income.

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

Overview: The source states will now be subject only to the conditions of their respective treaties with State W and will no longer be obliged to apply their treaties with State L. This means they are no longer subject to multiple treaty conditions in respect of the same income. In relation to income from shipping and air transport, however, this is unlikely to have any practical impact since State R and State PE will continue to be prevented from imposing tax under their respective treaties with State W. Nevertheless, this does resolve the uncertain application of Article 8 of the treaties between State L and the source states, since these treaties no longer apply, and could have an impact where the relevant terms of the treaties differ. Note that the proposals relating to reverse PE triangular cases do not apply here, since those proposals deal only with situations involving interest and royalties.

3.8. 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 it 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.1603

This section deals with a situation where a dual resident person, resident in State W and in State L, derives a capital gain from the alienation of immovable property located outside those two states. The

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1603 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.).
amount giving rise to the gain is paid by a resident of State R and originate from a PE of the payor located in State PE. The residence of the dual resident person is assigned to State W for the purposes of the treaty between the two residence states. For the purposes of the discussion below, it will generally be assumed that the immovable property from which the gain arises is located in State PE. This situation is illustrated in the diagram below (in which “HO” denotes head office):

For a more detailed discussion of dual resident triangular cases, refer to Chapter 9 (Section 9.4.). For a brief overview of the application of tax treaties in reverse PE triangular cases involving such gains, refer to Chapter 12 (Section 12.2.3.).

3.8.1. Existing treaty framework

The payor’s residence state (State R): State R must apply the conditions of both the W-R treaty and the L-R treaty. Article 13(1) will not apply for the purposes of either of these treaties 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 R will be prevented from imposing tax on the capital gain.\(^{1604}\) Note that if the property were instead located in State R, then State R would be entitled to impose tax in accordance with Article 13(1).

The payor’s PE state (State PE): State PE must apply the conditions of both the W-PE treaty and the L-PE treaty. For the purposes of both these treaties, Article 13(1) applies and State PE will be entitled to impose tax on the capital gain. Note that if the property were instead located outside State PE, e.g., in State R, then Article 13(5) would apply and State PE would be prevented from imposing any tax on the gain.

The losing residence state (State L): State L must apply the conditions of the W-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 winning residence state (State W): State W must apply the conditions of the W-R treaty, the W-PE treaty and the W-L treaty. State W may impose tax, but will be required to provide relief (either exemption or credit) under the W-PE treaty (i.e., under its treaty with the state where the property is located).

Overview: In this situation, tax may be imposed in the state where the immovable property is located (State PE) and in State W, and State W is obliged to provide relief (either exemption or credit, depending on the terms of the treaty). One issue which arises in this situation is that the source states, State R and State PE, will be bound by multiple treaty conditions in respect of the capital gain (i.e., their respective treaties with both State W and State L). This is unlikely to have any practical impact in most cases, but it could alter the source states’ ability to impose tax if the relevant conditions of the two treaties differ, since the source states can only satisfy their treaty obligations by applying the terms of the treaty that are most favourable to the taxpayer.

\(^{1604}\) 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).
3.8.2. Application of proposed solutions

The payor’s residence state (State R): State R must continue to apply the conditions of the W-R treaty but no longer has to apply the L-R treaty. This is unlikely to have any practical impact, however, since State R will continue to be prevented from imposing tax under Article 13(5) of the W-R treaty.

The payor’s PE state (State PE): State PE must continue to apply the conditions of the W-PE treaty but no longer has to apply the L-PE treaty. Again, this is unlikely to have any practical impact since State PE will simply continue to apply Article 13(1) of the W-PE treaty, under which it may impose tax on the gain.

The losing residence state (State L): State L will continue to apply the W-L treaty. For the purposes of this treaty, Article 13(5) will apply and State L will continue to be prevented from imposing any tax on the gain.

The winning residence state (State W): State W must continue to apply the conditions of the W-R treaty, the W-PE treaty and the W-L treaty. State W may impose tax on the capital gain and, since all the other states are prevented from imposing tax under their respective treaties with State W, State W will have no obligation to provide relief.

Overview: The source states will now be subject only to the conditions of their respective treaties with State W and will no longer be obliged to apply their treaties with State L, which means they are no longer subject to multiple treaty conditions in respect of the same capital gain. This is unlikely to have any practical impact, however, unless there is some difference between the terms of the two treaties that has an impact on the source state’s ability to impose tax. Note that the proposals relating to reverse PE triangular cases do not apply here, since those proposals deal only with situations involving interest and royalties.

3.9. 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 deals with a situation where a dual resident person, resident in State W and in State L, derives a capital gain from the alienation of movable property that forms part of the business property of a PE. The residence of the dual resident person deriving the gain is assigned to State W for the purposes of the treaty between the two residence states. The amount giving rise to the gain is paid by a resident of State R and originates from a PE of the payor located in State PE. The discussion in this appendix generally assumes that the dual-resident does not have a PE in either of the source states, however for the purposes of discussing this category of capital gains, it will be assumed that the movable property forms part of the business property of a PE located in State PE (i.e., the PE state of the payor). This situation is illustrated in the following diagram (in which “HO” denotes head office):

For a more detailed discussion of dual resident triangular cases, refer to Chapter 9 (Section 9.4.). For a brief overview of the application of tax treaties in reverse PE triangular cases involving such gains, refer to Chapter 12 (Section 12.2.3.).
3.9.1. Existing treaty framework

The payor’s residence state (State R): State R must apply the conditions of both the W-R treaty and the L-R treaty. Article 13(2) will not apply for the purposes of either of these treaties because the capital gain does not arise from the alienation of movable property of a PE located in State R. Instead, Article 13(5) will apply (since none of the other paragraphs of Article 13 apply) and State R will be prevented from imposing tax on the capital gain.\textsuperscript{1605}

The payor’s PE state (State PE): State PE must apply the conditions of both the W-PE treaty and the L-PE treaty. Article 13(2) applies for the purposes of both these treaties and state PE will be entitled to impose tax on the capital gain.

The losing residence state (State L): State L must apply the conditions of the W-L treaty. Article 13(2) will not apply for the purposes of this treaty because the capital gain does not arise from the alienation of movable property of a PE located in State L. 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.\textsuperscript{1606}

The winning residence state (State W): State W must apply the conditions of the W-R treaty, the W-PE treaty and the W-L treaty. State W may impose tax, but will be required to provide relief (either exemption or credit) under the W-PE treaty.

Overview: In this situation, tax may be imposed in the state where the PE to which the property belongs is located (State PE) and in State W, and State W is obliged to provide relief (either exemption or credit). State R and State L are both prevented from imposing tax under their respective treaties with State W. One issue which arises in this situation is that the source states, State R and State PE, will be bound by multiple treaty conditions in respect of the capital gain (i.e., their respective treaties with both State W and State L). This is unlikely to have any practical impact in most cases, but it could alter the source states’ ability to impose tax if the relevant conditions of the two treaties differ.

3.9.2. Application of proposed solutions

The payor’s residence state (State R): State R must continue to apply the conditions of the W-R treaty but no longer has to apply the L-R treaty. This is unlikely to have any practical impact, however, since Article 13(5) of the W-R treaty will continue to apply and will continue to prevent State R from imposing any tax on the gain.

The payor’s PE state (State PE): State PE must continue to apply the conditions of the W-PE treaty but no longer has to apply the L-PE treaty. Again, this is unlikely to have any practical impact since State PE will simply continue to apply Article 13(2) of the W-PE treaty, under which it may impose tax on the gain.

The losing residence state (State L): State L will continue to apply the W-L treaty. For the purposes of this treaty, Article 13(5) will apply and State L will continue to be prevented from imposing any tax on the gain.

The winning residence state (State W): State W must continue to apply the conditions of the W-R treaty, the W-PE treaty and the W-L treaty. State W may impose tax on the capital gain and, since all the other states are prevented from imposing tax under their respective treaties with State W, State W will have no obligation to provide relief.

\textsuperscript{1605} 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).

\textsuperscript{1606} 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).
Overview: The source states will now be subject only to the conditions of their respective treaties with State W and will no longer be obliged to apply their treaties with State L. This means they are no longer subject to multiple treaty conditions in respect of the same capital gain. This is unlikely to have any practical impact, however, unless there is some difference between the terms of the two treaties. Note that the proposals relating to reverse PE triangular cases do not apply here, since those proposals deal only with situations involving interest and royalties.

3.10. 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 dual resident person, resident in State W and in State L, derives a capital gain from the alienation of ships, aircraft and/or associated assets. The place of effective management of the person deriving the capital gain is located in State W and consequently, the residence of the dual resident person is assigned to State W for the purposes of the treaty between the two residence states. The amount giving rise to the gain is paid by a resident of State R and originate from a PE of the payor located in State PE. 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 a more detailed discussion of dual resident triangular cases, refer to Chapter 9 (Section 9.4.). For a brief overview of the application of tax treaties in reverse PE triangular cases involving such gains, refer to Chapter 12 (Section 12.2.3.).

3.10.1. Existing treaty framework

The payor’s residence state (State R): State R must apply the conditions of both the W-R treaty and the L-R treaty. For the purposes of both these treaties, Article 13(3) will apply and the gain may only be taxed in the state where the place of effective management is located. For the purposes of the W-R treaty, it is quite clear that, since the place of effective management is located in State W, State R will be prevented from imposing tax on the gain. For the purposes of the L-R treaty, however, the place of effective management is located in a third state and it is thus unclear how Article 13(3) should be applied. In any case, this will not have any practical impact since State R is already prevented from imposing tax under the W-R treaty.

The payor’s PE state (State PE): State PE must apply the conditions of both the W-PE treaty and the L-PE treaty. For the purposes of both these treaties, Article 13(3) will apply and the gain may only be taxed in the state where the place of effective management is located. For the purposes of the W-PE treaty, it is quite clear that, since the place of effective management is located in State W, State PE will be prevented from imposing tax on the gain. For the purposes of the L-PE treaty, however, the place of effective management is located in a third state and it is thus unclear how Article 13(3) should be applied.1607 In

1607 This is discussed further in Chapter 2 (see Section 2.7.).
any case, this will not have any practical impact since State PE is already prevented from imposing tax under the W-PE treaty.

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

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

Overview: In this situation, tax may only be imposed in State W. All the other states involved will be prevented from imposing tax under Article 13(3) of their respective treaties with State W. One issue which arises in this situation is that the source states, State R and State PE, will be bound by multiple treaty conditions in respect of the capital gain (i.e., their respective treaties with both State W and State L). This is unlikely to have any practical impact in most cases, but it could alter the source states’ ability to impose tax if the relevant conditions of the two treaties differ. It is also unclear how Article 13(3) of the treaties between State L and the source states should be applied, given that the place of effective management of the person deriving the gain is located outside the contracting states.

3.10.2. Application of proposed solutions

The payor’s residence state (State R): State R must continue to apply the conditions of the W-R treaty but no longer has to apply the L-R treaty. This is unlikely to have any practical impact, however, since State R will continue to be prevented from imposing tax under Article 13(3) of the W-R treaty.

The payor’s PE state (State PE): State PE must continue to apply the conditions of the W-PE treaty but no longer has to apply the L-PE treaty. Again, this is unlikely to have any practical impact since State PE will continue to be prevented from imposing tax under Article 13(3) of the W-PE treaty.

The losing residence state (State L): State L will continue to apply the W-L treaty. For the purposes of this treaty, Article 13(3) will apply and State L will be prevented from imposing any tax on the gain.

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

Overview: The source states will now be subject only to the conditions of their respective treaties with State W and will no longer be obliged to apply their treaties with State L. This means they are no longer subject to multiple treaty conditions in respect of the same capital gain. In relation to capital gains from the alienation of ships, aircraft and similar assets, however, this is unlikely to have any practical impact since State R and State PE will continue to be prevented from imposing tax under their respective treaties with State W. Nevertheless, this does resolve the uncertainty regarding the application of Article 13(3) of the treaties between State L and the source states, since these treaties no longer apply. Note that the proposals relating to reverse PE triangular cases do not apply here, since those proposals deal only with situations involving interest and royalties.

3.11. 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:

1. The alienation of shares in a company having more than 50% of its assets located in the source state;\(^{1608}\)
2. 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.\(^{1609}\)

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

![Diagram showing the flow of capital gain from State R to State PE to State W with State K as an intermediate PE]

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

For a more detailed discussion of dual resident triangular cases, refer to Chapter 9 (Section 9.4.). For a brief overview of the application of tax treaties in reverse PE triangular cases involving such gains, refer to Chapter 12 (Section 12.2.3.).

### 3.11.1. Existing treaty framework

**The payor's residence state (State R):** State R must apply the conditions of both the W-R treaty and the L-R treaty. Article 13(4) will not apply for the purposes of either of these treaties because the underlying property is not located in State R. Instead, since none of the other paragraphs of Article 13 apply, Article 13(5) will apply and State R will be prevented from imposing any tax on the gain.\(^{1610}\)

**The payor's PE state (State PE):** State PE must apply the conditions of both the W-PE treaty and the L-PE treaty. For the purposes of both these treaties Article 13(4) will apply, since the underlying immovable property is located in State PE, and State PE may impose tax on the gain.

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\(^{1609}\) See, for example the reservations of France, Chile, Sweden and Korea in the OECD Commentary to Article 13 of the OECD Model.

\(^{1610}\) 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).
The losing residence state (State L): State L must apply the conditions of the W-L treaty. For the purposes of this treaty, Article 13(4) will not apply because the underlying property is not 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.1611

The winning residence state (State W): State W must apply the conditions of the W-R treaty, the W-PE treaty and the W-L treaty. State W may impose tax on the gain, but will be obliged to provide relief for tax imposed in State PE under the W-PE treaty (either credit or exemption). State W will not have any relief obligation under the W-R treaty or the W-L treaty because both State R and State L are prevented from imposing tax under their respective treaties with State W.

Overview: In this situation, tax may be imposed in State W and in State PE and State W will be obliged to provide relief. One issue which arises in this situation is that the source states, State R and State PE, will be bound by multiple treaty conditions in respect of the capital gain (i.e., their respective treaties with both State W and State L). This is unlikely to have any practical impact in most cases, but it could alter the source states’ ability to impose tax if the relevant conditions of the two treaties differ.

3.11.2. Application of proposed solutions

The payor’s residence state (State R): State R must continue to apply the conditions of the W-R treaty but no longer has to apply the L-R treaty. This is unlikely to have any practical impact, however, since State R will continue to be prevented from imposing tax under Article 13(5) of the W-R treaty. Article 13(4) will not apply because the underlying immovable property is not located in State R.

The payor’s PE state (State PE): State PE must continue to apply the conditions of the W-PE treaty but no longer has to apply the L-PE treaty. Again, this is unlikely to have any practical impact since State PE will continue to apply Article 13(4) of the W-PE treaty and may still impose tax on the gain.

The losing residence state (State L): State L must continue to apply the W-L treaty. For the purposes of this treaty, Article 13(4) will not apply because the underlying property is not located in State L. Instead, Article 13(5) will apply and State L will be prevented from imposing any tax on the gain.

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

Overview: The source states will now be subject only to the conditions of their respective treaties with State W and will no longer be obliged to apply their treaties with State L. This means they are no longer subject to multiple treaty conditions in respect of the same capital gain. In relation to capital gains from the alienation of shares deriving their value from immovable property, however, this is unlikely to have any practical impact since State R will continue to be entitled to impose tax under its treaty with State W and State PE will continue to be prevented from imposing tax under its treaty with State W. Note that the proposals relating to reverse PE triangular cases do not apply here, since those proposals deal only with situations involving interest and royalties.

3.12. 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:

1611 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).
“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 dual resident person, resident in State W and in State L, derives a capital gain from the alienation of other property located outside those two states. The residence of the dual resident person deriving the gain is assigned to State W for the purposes of the treaty between the two residence states. The amount giving rise to the capital gain is paid by a resident of State R and originates from a PE of the payor located in State PE. This situation is illustrated in the following diagram (in which “HO” denotes head office):

For a more detailed discussion of dual resident triangular cases, refer to Chapter 9 (Section 9.4.). For a brief overview of the outcome of reverse PE triangular cases involving capital gains dealt with under Article 13(5), refer to Chapter 12 (Section 12.2.3.).

3.12.1. Existing treaty framework

The payor's residence state (State R): State R must apply the conditions of both the W-R treaty and the L-R treaty. For the purposes of both these treaties, Article 13(5) will apply and State R will be prevented from imposing tax on the gain.

The payor's PE state (State PE): State PE must apply the conditions of both the W-PE treaty and the L-PE treaty. For the purposes of both these treaties, Article 13(5) will apply and State PE will be prevented from imposing tax on the gain.

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

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

Overview: In this situation, tax may only be imposed in State W. One issue which arises in this situation is that the source states, State R and State PE, will be bound by multiple treaty conditions in respect of the capital gain (i.e., their respective treaties with both State W and State L). This is unlikely to have any practical impact in most cases, but it could alter the source states’ ability to impose tax if the relevant conditions of the two treaties differ.

3.11.2. Application of proposed solutions

The payor's residence state (State R): State R must continue to apply the conditions of the W-R treaty but no longer has to apply the L-R treaty. This is unlikely to have any practical impact, however, since State R will continue to be prevented from imposing tax under Article 13(5) of the W-R treaty.

The payor's PE state (State PE): State PE must continue to apply the conditions of the W-PE treaty but no longer has to apply the L-PE treaty. Again, this is unlikely to have any practical impact since State PE will continue to be prevented from imposing any tax under Article 13(5) of the W-PE treaty.
The losing residence state (State L): State L will continue to apply the W-L treaty. For the purposes of this treaty, Article 13(5) will apply and State L will be prevented from imposing any tax on the gain.

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

Overview: The source states will now be subject only to the conditions of their respective treaties with State W and will no longer be obliged to apply their treaties with State L. This means they are no longer subject to multiple treaty conditions in respect of the same capital gain. This is unlikely to have any practical impact, however, since they will both continue to be prevented from imposing tax under their respective treaties with State W. Note that the proposals relating to reverse PE triangular cases do not apply here, since those proposals deal only with situations involving interest and royalties.

3.13. 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 dual resident person, resident in State W and in State L, receives other income from outside those two states. The residence of the dual resident person is assigned to State W for the purposes of the treaty between the two residence states. The income is paid by a resident of State R and originates from a PE of the payor located in State PE. This situation is illustrated in the following diagram (in which “HO” denotes head office):

For a more detailed discussion of dual resident triangular cases, refer to Chapter 9 (Section 9.4.). For a brief overview of the outcome of a reverse PE triangular case involving other income, refer to Chapter 12 (Section 12.2.3.).

3.13.1. Existing treaty framework
The payor’s residence state (State R): State R must apply the conditions of both the W-R treaty and the L-R treaty. For the purposes of both these treaties, Article 21 will apply and State R will be prevented from imposing tax on the income.

The payor’s PE state (State PE): State PE must apply the conditions of both the W-PE treaty and the L-PE treaty. For the purposes of both these treaties, Article 21 will apply and State PE will be prevented from imposing tax on the income.

The losing residence state (State L): State L must apply the conditions of the W-L treaty. For the purposes of this treaty, Article 21 will apply and State L will be prevented from imposing tax on the income.

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

Overview: In this situation, tax may only be imposed in State W. One issue which arises in this situation is that the source states, State R and State PE, will be bound by multiple treaty conditions in respect of the capital gain (i.e., their respective treaties with both State W and State L). This is unlikely to have any practical impact in most cases, but it could alter the source states’ ability to impose tax if the relevant conditions of the two treaties differ.

3.13.2. Application of proposed solutions

The payor’s residence state (State R): State R must continue to apply the conditions of the W-R treaty but no longer has to apply the L-R treaty. This is unlikely to have any practical impact, however, since State R will continue to be prevented from imposing tax under Article 21 of the W-R treaty.

The payor’s PE state (State PE): State PE must continue to apply the conditions of the W-PE treaty but no longer has to apply the L-PE treaty. Again, this is unlikely to have any practical impact since State PE will continue to be prevented from imposing any tax under Article 21 of the W-PE treaty.

The losing residence state (State L): State L will continue to apply the W-L treaty. For the purposes of this treaty, Article 21 will apply and State L will be prevented from imposing any tax on the income.

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

Overview: The source states will now be subject only to the conditions of their respective treaties with State W and will no longer be obliged to apply their treaties with State L, which means they are no longer subject to multiple treaty conditions in respect of the same capital gain. This is unlikely to have any practical impact, however, since they will both continue to be prevented from imposing tax under their respective treaties with State W. Note that the proposals relating to reverse PE triangular cases do not apply here, since those proposals deal only with situations involving interest and royalties.

3.14. Conclusions

This section has discussed a situation where a dual resident triangular case is combined with a reverse PE 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 PE triangular cases only give rise to dual source-based taxation in relation to interest income and royalties (where the applicable treaties differ from the OECD Model) and thus, dual source based taxation may only occur here where interest and royalties are involved. In all other cases, the outcome in this situation is essentially the same as the outcome in a dual resident triangular case (outlined in Chapter 9).
The primary issue in dual resident triangular cases is the application of multiple treaty conditions in the source state or states. Where this occurs, the source states can only meet their treaty obligations by applying the terms of the treaty that are most favourable to the person deriving the income (or capital gain). Preventing a dual resident from being resident in their losing residence state for the purposes of treaties between that state and third states ensures that the source states are not subject to multiple treaty conditions in relation to the income and capital gains derived by the dual resident. It means that the source states will only be subject to the conditions of their treaties with the state to which the dual resident’s residence is assigned under the tie-breaker provision of the treaty between the two residence states, i.e., the winning residence state. It also addresses concerns regarding improper access to the treaties concluded between the losing residence state and third states in situations where the losing residence state is prevented from imposing tax under the treaty between the two residence states.

The analysis in this section has also demonstrated the application of the proposed solution for reverse PE triangular cases involving interest. Under this proposed solution, interest which originates in a PE in a third state is not considered to arise in the residence state of the payor (subject to certain conditions) under Article 11(5). As a result, the residence state of the payor is not entitled to impose tax under Article 11 and is prevented from imposing tax under either Article 7 or Article 21. Source-based taxation may therefore only be imposed in the PE state of the payor. A similar solution is proposed for royalties in situations where the applicable treaties differ from the OECD Model (as many concluded treaties do) and allow source based taxation of royalties under Article 12.

Finally, the analysis in this section has uncovered no special problems relating to the interaction of the proposed solutions for dual resident triangular cases and for reverse PE triangular cases, and no problems or issues which require special consideration. As mentioned above, the issues arising in the situations discussed in this section are generally the same as those arising in the relevant basic triangular cases.