Triangular cases: The application of bilateral tax treaties in multilateral situations
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Section IV: Dual-resident triangular case combined with a reverse dual-resident triangular case

4.1. Introduction

The case discussed in this section is a combination of a dual resident triangular case\(^\text{1612}\) and a reverse dual resident triangular case\(^\text{1613}\). It involves a person who is resident in two states receiving income from a person who is resident in two other states.

The recipient of the income is resident in “State W1” and “State L1” under their respective domestic laws and for treaty purposes. For the purposes of the treaty between these two states (the W1-L1 treaty), the tie-breaker provision assigns residence to State W1 (also referred to as the winning residence state). The state to which residence is not assigned is referred to as State L1 (or the losing residence state).

The payor of the income is resident in “State W2” and “State L2” under their respective domestic laws and for treaty purposes. For the purposes of the treaty between these two states (the W2-L2 treaty), the tie-breaker provision assigns residence to State W2 (also referred to as the winning residence state). The state to which residence is not assigned is referred to as State L2 (or the losing residence state), State W2 and State L3 are collectively referred to as the “source states.”

Finally, it is assumed that neither the payor nor the recipient has a PE in any state, including their respective losing residence states. This situation is illustrated in the following diagram:

For the purposes of this analysis, it is assumed that the allocation of residence under the tie-breaker provision of a particular treaty is not effective for the purposes of treaties concluded between the losing residence state and third states. This means that any amount received by the dual resident recipient will continue to be received by a resident of State L1 for the purposes of that state’s treaties with the source states. It also means that any amount paid by the dual resident payor will continue to be considered to be paid by a resident of State L2 for the purposes of that state’s treaties with the recipient of the income. This assumption is not free from doubt; for further discussion of the application of treaties between a losing residence state and third states, please refer to Chapter 11.\(^\text{1614}\)

4.1.1. 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 winning residence state of the payor (the W1-W2 treaty);

\(^{1612}\) For a detailed overview of the application of tax treaties in dual resident triangular cases, refer to Chapter 9.

\(^{1613}\) For a detailed discussion of reverse dual resident triangular cases, refer to Chapter 12 (Section 12.3.).

\(^{1614}\) 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.).
(ii) the treaty between the losing residence state of the recipient and the winning residence state of the payor (the L1-W2 treaty);

(iii) the treaty between the winning residence state of the recipient and the losing residence state of the payor (the W1-L2 treaty);

(iv) the treaty between the losing residence state of the recipient and the losing residence state of the payor (the L1-L2 treaty); and

(v) the treaty between the winning and losing residence states of the recipient (the W1-L1 treaty).

The treaty between the payor's residence state and the payor's PE state (the W2-L2 treaty) will not apply because for the purposes of this treaty, the income is not received by a resident of one of the contracting states.

4.1.2. 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 dual resident triangular cases. In fact, as will be seen below, there is a single solution proposed to deal with both these types of 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 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(s) where income arises. As a result, source state(s) would no longer be subject to multiple treaty conditions in respect of income derived by a dual-resident.

In the case of a dual-resident making payments of passive income to residents of a third state, this would mean that the dividends, interest or royalties would be paid by a person who is not resident of the losing residence state for the purposes of the treaty between that state and the state where the person receiving the income is resident (e.g., the W1-L2 treaty). As will be seen below, the losing residence state of the payor (State L2) would generally be prevented from imposing source-based taxation as a result.

For the purposes of the discussion in this appendix, it is assumed that the dual-resident recipient of the income does not have a PE in the losing residence state (State L1) and thus, will State L1 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

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1615 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.).

1616 This proposed provision is extracted from Chapter 11 (Section 11.3.2.) where it is discussed in-depth.

1617 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.).

1618 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.
implementing the extension of treaty benefits to PEs as outlined briefly above.\textsuperscript{1619} It is further assumed that the dual-resident payor does not have a PE in its losing residence state. If it did have a PE in that state, then that state may be entitled to impose tax on certain types of income to the extent that they originate from the PE; this would effectively be a reverse PE triangular case. This would effectively be the same as a situation combining a dual resident triangular situation and a reverse PE triangular case; such cases are discussed in Section S4.4. above.

\textit{Applicable treaties}

If the proposed provisions are included in all the relevant treaties, the applicable treaties in this case will be:

(i) the treaty between the winning residence state of the recipient and the winning residence state of the payor (the W1-W2 treaty);

(ii) the treaty between the winning residence state of the recipient and the losing residence state of the payor (the W1-L2 treaty); and

(iii) the treaty between the winning and losing residence states of the recipient (the W1-L1 treaty)

The treaty between the payor's residence states (the W2-L2 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 L1 for treaty purposes, the L1-W2 treaty and the L1-L2 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.

\subsection*{4.2. Business profits}

Article 7 deals with business profits and allows the residence state of the person deriving the income to impose tax. It also allows the other contracting state to impose tax, but only in relation to profits which are attributable to a PE in that other state.\textsuperscript{1620} Article 7 (in paragraphs 1 and 2) provides as follows:

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

2. For the purposes of this Article and Article [23 A] [23B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.”\textsuperscript{1621}
\end{quote}

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

This section deals with a situation where a dual resident person, resident in State W1 and in State L1, derives business profits from outside those two states. The income is also paid by a dual resident, a person who is resident in State W2 and in State L2. The residence of the recipient of the income is

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\textsuperscript{1619} For a brief overview of this proposal, see Section S4.2.1. above. This proposal is discussed in detail throughout Chapter 7 and Chapter 8.

\textsuperscript{1620} The term “permanent establishment” is defined in Article 5.

\textsuperscript{1621} Article 7, paragraphs 1 and 2.
assigned to State W1 under the tie-breaker provision of the W1-L1 treaty, and the residence of the payor is assigned to State W2 under the tie-breaker provision of the W2-L2 treaty. This situation is illustrated in the following diagram:

For a more detailed discussion of dual resident triangular cases, refer to Chapter 10 (in particular, Section 10.4.). For a more detailed discussion of reverse dual resident triangular cases, including a brief overview of the outcome of reverse dual-resident triangular cases involving business profits, refer to Chapter 12 (Section 12.3.).

4.2.1. Existing treaty framework

The winning residence state of the payor (State W2): State W2 must apply the conditions of both the W1-W2 treaty and the L1-W2 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 W2, State W2 will be prevented from imposing tax.

The losing residence state of the payor (State L2): State L2 must apply the conditions of both the W1-L2 treaty and the L1-L2 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 L2, State L2 will be prevented from imposing tax.

The losing residence state of the recipient (State L1): State L1 must apply the conditions of the W1-L1 treaty. For the purposes of this treaty, Article 7 will apply and State L1 will be prevented from imposing tax.

The winning residence state of the recipient (State W1): State W1 must apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax and, since State W2, State L2 and State L1 are all prevented from imposing tax, State W1 will have no obligation to provide relief.

Overview: Under the existing treaty framework, tax may only be imposed in State W1 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, although though this would generally have no practical impact (at least where the applicable treaties follow the OECD Model).

4.2.2. Application of proposed solutions

The winning residence state of the payor (State W2): State W2 must continue to apply the conditions of the W1-W2 treaty but no longer has to apply the L1-W2 treaty. For the purposes of the W1-W2 treaty, Article 7 will apply and State W2 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 W1-W2 treaty and the L1-W2 treaty.

The losing residence state of the payor (State L2): State L2 must continue to apply the conditions of the W1-L2 treaty but no longer has to apply the L1-L2 treaty. For the purposes of the W1-L2 treaty, Article 7 will apply and State L2 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 W1-L2 treaty and the L1-L2 treaty.
The losing residence state of the recipient (State L1): State L1 must continue to apply the conditions of the W1-L1 treaty. For the purposes of this treaty, Article 7 will apply and State L1 will be prevented from imposing tax on the income.

The winning residence state of the recipient (State W1): State W1 must continue to apply the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax and, since all the other states are prevented from imposing tax under their respective treaties with State W1, State W1 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 W2 and State L2) treaties with State W1 differ from those contained in their treaties with State L1. As a result, one of the source state’s may be entitled to impose tax under the conditions of its treaty with State W1 but not under the conditions of its treaty with State L1 or vice versa. Note that the fact that the payor is no longer considered resident in State L2 for treaty purposes has no impact in this situation, since the residence of the payor has no influence on the source state’s taxing rights in relation to income dealt with under Article 7.

4.3. 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.\textsuperscript{1622} 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 W1 and in State L1, receives dividends from outside those two states. The dividends are also paid by a dual resident, a person who is resident in State W2 and in State L2. The residence of the recipient of the dividends is assigned to State W1 under the tie-breaker provision of the W1-L1 treaty, and the residence of the payor is assigned to State W2 under the tie-breaker provision of the W2-L2 treaty. This situation is illustrated in the following diagram:

\textsuperscript{1622} 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.).
For a more detailed discussion of dual resident triangular cases, refer to Chapter 10 (in particular, Section 10.4.). For a detailed discussion of reverse dual resident triangular cases involving dividends, refer to Chapter 12 (Section 12.3.4.).

4.3.1. Existing treaty framework

The winning residence state of the payor (State W2): State W2 must apply the conditions of both the W1-W2 treaty and the L1-W2 treaty. For the purposes of both these treaties, Article 10 will apply and State W2 will be entitled to impose tax on the dividends at a limited rate. If the applicable rate differs between the two treaties, State W2 can only satisfy its treaty obligations by applying the lower of the two rates.1623

The losing residence state of the payor (State L2): State L2 must apply the conditions of both the W1-L2 treaty and the L1-L2 treaty. For the purposes of both these treaties, Article 10 will apply and State L2 will be entitled to impose tax on the dividends at a limited rate. If the applicable rate differs between the two treaties, State L2 can only satisfy its treaty obligations by applying the lower of the two rates.1624 State L2 may be prevented from imposing tax, however, under Article 10(5) of the W2-L2 treaty.1625 State L2 may be prevented from imposing tax, however, under Article 10(5) of the W2-L2 treaty.1625

The losing residence state of the recipient (State L1): State L1 must apply the conditions of the W1-L1 treaty. Article 10 will not apply because the dividends are not paid by a resident of State L1. Instead, either Article 7 or Article 21 will apply, depending on whether the dividends are considered to be business profits. Regardless of which of these two articles applies, State L1 will be prevented from imposing any tax on the dividends.

The winning residence state of the recipient (State W1): State W1 must apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax but will be obliged to provide relief (using the credit method) for tax imposed in State W2 and possibly also State L2 (no relief will be required if State L2 is prevented from imposing tax under Article 10(5) of the W2-L2 treaty). State W1 will not be obliged to provide any relief under the W1-L1 treaty, since State L1 is prevented from imposing tax under its treaty with State W1. There will be no unrelieved double taxation.


1625 Article 10(5) provides that: "Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment situated in that other State; nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State." Thus, this provision should prevent the losing residence state from imposing tax on the dividends. The main problem with applying this provision is that it applies under the treaty between the two resident states of the payor and, for the purposes of this treaty, the recipient of the dividends is not a resident of either of the contracting states. In addition, it may apply only where the company derives profits or income from the state seeking to impose tax on the dividends. Article 10(5) is discussed in detail in Chapter 12 (see Section 12.2.1. and Section 12.3.4.).
Overview: In this situation, tax may be imposed in State W2, State W1 and potentially also in State L2. State W1 will have an obligation to provide relief (using the credit method) for tax imposed in State W2 and, if applicable, State L2. An important issue in this situation is that both State W2 and State L2 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 L1-W2 treaty, particularly given that State L1 is prevented from imposing any tax on the dividends by the conditions of the W1-L1 treaty. Another important issue is the potential for dual source-based taxation (subject to the application of Article 10(5) of the treaty between the two residence states of the payor) and, if State W1 cannot provide sufficient relief, unrelieved double taxation.

4.3.2. Application of proposed solutions

The winning residence state of the payor (State W2): State W2 must continue to apply the conditions of the W1-W2 treaty but no longer has to apply the L1-W2 treaty. For the purposes of the W1-W2 treaty, Article 10 will apply and State W2 will be entitled to impose tax on the dividends at a limited rate. State W2 is no longer required to apply multiple treaty conditions.

The losing residence state of the payor (State L2): State L2 must continue to apply the conditions of the W1-L2 treaty but no longer has to apply the L1-L2 treaty. In addition, the payor of the dividends will no longer be considered a resident of State L2 for the purposes of the W1-L2 treaty. As a result, Article 10 of the W1-L2 treaty will not apply. Instead, Article 7 or Article 21 will apply, depending on whether the dividends are considered to be business profits, and State L2 will be prevented from imposing tax. If State L2 is prevented from imposing tax as a result of Article 10(5) of the W2-L2 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 L2 from imposing tax). However, there is some uncertainty regarding the application of Article 10(5) in this situation and preventing State L2 from imposing tax under the terms of the W1-L2 treaty makes the outcome clearer and more certain.

The losing residence state of the recipient (State L1): State L1 must continue to apply the W1-L1 treaty. For the purposes of this treaty, Article 10 will not apply because the dividends are not paid by a resident of State L1. Instead, Article 7 or Article 21 will apply, depending on whether the income is considered to be business profits, and State L1 will be prevented from imposing any tax on the income.

The winning residence state of the recipient (State W1): State W1 must continue to apply the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax but is obliged to provide relief (using the credit method) for tax imposed in State W2. State W1 will not be obliged to provide relief under the W1-L2 treaty or the W1-L1 treaty since both State L2 and State L1 are prevented from imposing tax.

Overview: The source states will now be subject only to the conditions of their respective treaties with State W1 and will no longer be obliged to apply their treaties with State L1. 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. Furthermore, under the proposed treaty provisions, the dual-resident payor of the dividends would no longer be considered a resident in State L2 for the purposes of the treaties between that state and the residence state (or states) of the recipient of the dividends. This makes it more certain that State L2 will be prevented from imposing tax and thus, that dual source-based taxation will be prevented.

4.4. 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.1626

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

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

This section deals with a situation where a dual resident person, resident in State W1 and in State L1, derives interest income from outside those two states. The interest is also paid by a dual resident, a person who is resident in State W2 and in State L2. The residence of the recipient of the interest is assigned to State W1 under the tie-breaker provision of the W1-L1 treaty, and the residence of the payor is assigned to State W2 under the tie-breaker provision of the W2-L2 treaty. This situation is illustrated in the following diagram:

For a more detailed discussion of dual resident triangular cases, refer to Chapter 10 (Section 10.4.). For a more detailed discussion of reverse dual resident triangular cases, refer to Chapter 12 (Section 12.3.).

4.4.1. Existing treaty framework

The winning residence state of the payor (State W2): State W2 must apply the conditions of the W1-W2 treaty and the L1-W2 treaty. Under Article 11(5) of both these treaties, the interest will be considered to arise in State W2 since it is paid by a resident of that state. Article 11 will therefore apply for the purposes of both treaties and State W2 will be entitled to impose a limited rate of tax on the interest. If the applicable rates differ between the two treaties, State W2 can only satisfy its treaty obligations by applying the lower of the two rates.1627

1626 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.”

The losing residence state of the payor (State L2): State L2 must apply the conditions of the W1-L2 treaty and the L1-L2 treaty. Under Article 11(5) of both these treaties, the interest will be considered to arise in State L2 since it is paid by a resident of that state. Article 11 will therefore apply and State L2 will be entitled to impose a limited rate of tax on the interest. If the applicable rate differs between the two treaties, State L2 can only satisfy its treaty obligations by applying the lower of the two rates.1628

The losing residence state of the recipient (State L1): State L1 must apply the conditions of the W1-L1 treaty. Article 11 will not apply for the purposes of the W1-L1 treaty since the interest is not paid by a resident of State L1. 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 L1, State L1 will be prevented from imposing tax.

The winning residence state of the payor (State W2): State W2 must continue to apply the conditions of the W1-W2 treaty but no longer has to apply the L1-W2 treaty. Under Article 11(5) of the W1-W2 treaty, the interest would be considered to arise in State W2 and State W2 would be entitled to impose tax in accordance with Article 11.

The losing residence state of the payor (State L2): State L2 must continue to apply the conditions of the W1-L2 treaty but no longer has to apply the L1-L2 treaty. For the purposes of the W1-L2 treaty, however, the payor of the interest will no longer be resident in State L2. As a result, the interest will not be considered to arise in State L2 under Article 11(5) and, consequently, Article 11 of the treaty will not apply. Instead Article 7 or Article 21 will apply, depending on whether the interest is considered to be business profits, and State L2 would be prevented from imposing tax on the income.

The losing residence state of the recipient (State L1): State L1 must continue to apply the W1-L1 treaty. Article 11 will not apply for the purposes of the W1-L1 treaty since the interest is not paid by a resident of State L1. 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 L1, State L1 will be prevented from imposing tax.

Overview: In this situation, source-based taxation may be imposed in both State W2 and State L2. For the purposes of State W2’s treaties with the two residence states, the interest is considered to arise in State W2 and for the purposes of State L2’s treaties with the two residence states, the interest is considered to arise in State L2. As a result, both State W2 and State L2 may impose tax on the interest under Article 11 of their respective treaties with State W1 and State L1. State W1 will be obliged to provide relief for tax imposed in both State W2 and State L2, but may not be able to provide sufficient relief to prevent double taxation. An important issue in this situation is that both State W2 and State L2 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 L1-W2 treaty, particularly given that State L1 is prevented from imposing any tax on the interest by the conditions of the W1-L1 treaty.

4.4.2. Application of proposed solutions

The winning residence state of the payor (State W2): State W2 must continue to apply the conditions of the W1-W2 treaty but no longer has to apply the L1-W2 treaty. Under Article 11(5) of the W1-W2 treaty, the interest would be considered to arise in State W2 and State W2 would be entitled to impose tax in accordance with Article 11.

The losing residence state of the payor (State L2): State L2 must continue to apply the conditions of the W1-L2 treaty but no longer has to apply the L1-L2 treaty. For the purposes of the W1-L2 treaty, however, the payor of the interest will no longer be resident in State L2. As a result, the interest will not be considered to arise in State L2 under Article 11(5) and, consequently, Article 11 of the treaty will not apply. Instead Article 7 or Article 21 will apply, depending on whether the interest is considered to be business profits, and State L2 would be prevented from imposing tax on the income.

The losing residence state of the recipient (State L1): State L1 must continue to apply the W1-L1 treaty. Article 11 will not apply for the purposes of the W1-L1 treaty since the interest is not paid by a resident of State L1. 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 L1, State L1 will be prevented from imposing tax.


1629 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 it is required to provide relief for tax imposed on a source basis in two separate states; this discussion is framed in terms of PE triangular cases but applies equally to other situations. Broadly, the residence state’s ability to grant sufficient relief will depend on the relative tax rates in the states involved and, where the residence state uses the credit method, will also depend on the applicable credit limitations.
The winning residence state of the recipient (State W1): State W1 must continue to apply the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax but is obliged to provide relief (using the credit method) for tax imposed in State W2. State W1 will not be obliged to provide relief under the W1-L2 treaty or the W1-L1 treaty, since both State W2 and State L1 are prevented from imposing tax.

Overview: The source states will now be subject only to the conditions of their respective treaties with State W1 and will no longer be obliged to apply their treaties with State L1. 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, since the payor of the interest is no longer considered to be resident in its losing residence state for the purposes of treaties between that state and third states, the interest is only considered to arise in one state for treaty purposes (i.e., State W2) and thus may not be subject to dual source-based taxation.

4.5. Royalties

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

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

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

As outlined in Chapter 12 (see Section 12.2.2.), the UN Model and many concluded treaties do allow states to impose a limited rate of source based taxation on royalties which arise in one contracting state and are paid to a resident of the other contracting state. In general, the rules for determining whether royalties arise in a particular state mirror the rules of Article 11(5) which apply in relation to interest. To the extent that the applicable treaties do allow source-based taxation of royalties and determine where royalties arise under a provision equivalent to Article 11(5), the analysis in relation to royalties would be 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 W1 and in State L1, derives royalties from outside those two states. The royalties are also paid by a dual resident, a person who is resident in State W2 and in State L2. The residence of the recipient of the royalties is assigned to State W1 under the tie-breaker provision of the W1-L1 treaty, and the residence of the payor is assigned to State W2 under the tie-breaker provision of the W2-L2 treaty. This situation is illustrated in the following diagram:

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1630 See, for example, Article 12(5) of the UN Model Treaty (2001), which provides that: "Royalties shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties was incurred, and such royalties are borne by such permanent establishment or fixed base, then such royalties shall be deemed to arise in the State in which the permanent establishment or fixed base is situated."

For a more detailed discussion of dual resident triangular cases, refer to Chapter 10 (Section 10.4.). For a more detailed discussion of reverse dual resident triangular cases, refer to Chapter 12 (Section 12.3.).

4.5.1. Existing treaty framework

The winning residence state of the payor (State W2): State W2 must apply the conditions of the W1-W2 treaty and the L1-W2 treaty. For the purposes of applying both these treaties the income would generally be considered to arise in State W2, in which case Article 12 would apply. If Article 12 of either of the two treaties does not allow any source based taxation, State W2 will be prevented from imposing tax. If both treaties do allow source-based taxation under Article 12 then State W2 would be entitled to impose tax at a limited rate. If the applicable rates differ between the two treaties, State W2 can only satisfy its treaty obligations by applying the lower of the two rates.1632

The losing residence state of the payor (State L2): State L2 must apply the conditions of the W1-L2 treaty and the L1-L2 treaty. For the purposes of applying these treaties the income would generally be considered to arise in State L2, in which case Article 12 would apply. If Article 12 of either of the two treaties does not allow any source based taxation, State L2 will be prevented from imposing tax. If both treaties do allow source-based taxation under Article 12 then State L2 would be entitled to impose tax at a limited rate. If the applicable rates differ between the two treaties, State L2 can only satisfy its treaty obligations by applying the lower of the two rates.1633

The losing residence state of the recipient (State L1): State L1 must apply the conditions of the W1-L1 treaty. Article 12 will not apply for the purposes of the W1-L1 treaty since the royalties would not generally be considered to arise in State L1. 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 L1, State L1 will be prevented from imposing tax.

The winning residence state of the recipient (State W1): State W1 must apply the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax, but to the extent that either State W2 or State L2 (or both) may impose tax on the income, State W1 will be obliged to grant relief. If State W1 has an obligation to provide relief for tax imposed in both these two states, it may not be able to provide sufficient relief to prevent unrelieved double taxation.1634

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 W2, in State L2, in both of these


1634 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 it is required to provide relief for tax imposed on a source basis in two separate states; this discussion is framed in terms of PE triangular cases but applies equally to other situations. Broadly, the residence state’s ability to grant sufficient relief will depend on the relative tax rates in the states involved and, where the residence state uses the credit method, will also depend on the applicable credit limitations.
states or in neither of them. State W1 will be obliged to provide relief, but if tax is imposed in both State W2 and in State L2, State W1 may not be able to provide sufficient relief to prevent double taxation. An important issue in this situation is that both State W2 and State L2 are subject to multiple treaty conditions in respect of the same income. This may also give rise to concerns about the potential for improper use of the treaties between State L1 and the source states, given that State L1 is prevented from imposing any tax on the royalties under the W1-L1 treaty.

4.5.2. Application of proposed solutions

The winning residence state of the payor (State W2): State W2 must continue to apply the conditions of the W1-W2 treaty but no longer has to apply the L1-W2 treaty. For the purposes of this treaty, the royalties would generally be considered to arise in State W2 and Article 12 would apply. Depending on the terms of Article 12, State W2 may either be prevented from imposing tax or may be entitled to impose tax at a limited rate.

The losing residence state of the payor (State L2): State L2 must continue to apply the conditions of the W1-L2 treaty but no longer has to apply the L1-L2 treaty. The payor of the royalties would no longer be considered to be resident in State L2 for the purposes of treaties concluded by that state with third states. For the purposes of the W1-L2 treaty, the royalties would therefore not be paid by a resident of State L2 and would not be considered to arise there.1635 As a result, Article 12 of the treaty would generally not apply. Instead Article 7 or Article 21 would apply, depending on whether the income is considered to be business profits, and State L2 would be prevented from imposing tax.

The losing residence state of the recipient (State L1): State L1 must continue to apply the W1-L1 treaty. Article 12 will not apply for the purposes of the W1-L1 treaty since the royalties do not arise in State L1. 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 L1, State L1 will be prevented from imposing tax.

The winning residence state of the recipient (State W1): State W1 must continue to apply the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax but if State W2 may also impose tax (under the W1-W2 treaty), then State W1 will be obliged to provide relief (using the credit method) for tax imposed in State W2. State W1 will not be obliged to provide relief under the W1-L2 treaty or the W1-L1 treaty, since both State L2 and State L1 are prevented from imposing tax.

Overview: The source states will now be subject only to the conditions of their respective treaties with State W1 and will no longer be obliged to apply the conditions of their treaties with State L1. This means they are no longer subject to multiple treaty conditions in respect of the same income, and also addresses the risk of improper use of the treaties between the losing residence state (State L1) and the source states. In addition, the payor of the royalties is no longer considered to be resident in its losing residence state (State L2) for the purposes of treaties between that state and third states. As a result, the royalties are no longer considered to arise in two separate states for treaty purposes and source-based taxation may only be imposed in State W2 (depending on the terms of Article 12 of the W1-W2 treaty). This ensures that there is no dual source-based taxation of the royalties.

4.6. 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.”

1635 Either under general principles or, if applicable, under the specific provision which is proposed to be included in Article 12 in situations where Article 12 allows source based taxation of royalties.
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.

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 it is attributable to a PE (i.e., as a result of Article 21(2)). The income 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 W1 and in State L1, derives income from immovable property located outside those two states. The income is also paid by a dual resident, a person who is resident in State W2 and in State L2. The residence of the recipient of the income is assigned to State W1 under the tie-breaker provision of the W1-L1 treaty, and the residence of the payor is assigned to State W2 under the tie-breaker provision of the W2-L2 treaty. For the purposes of the analysis below, it is assumed that the immovable property is located in State L2. This situation is illustrated in the following diagram:

For a more detailed discussion of dual resident triangular cases, refer to Chapter 10 (Section 10.4 For a more detailed discussion of reverse dual resident triangular cases, refer to Chapter 12 (Section 12.3.).

4.6.1. Existing treaty framework

The winning residence state of the payor (State W2): State W2 must apply the conditions of both the W1-W2 treaty and the L1-W2 treaty. Article 6 will not apply for the purposes of either of these treaties because the immovable property is not located in State W2. Instead, Article 7 or Article 21 will apply (depending on whether the income is considered to be business profits) and State W2 is prevented from imposing tax on the income.

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1636 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.”

The losing residence state of the payor (State L2): State L2 must apply the conditions of both the W1-L2 treaty and the L1-L2 treaty. For the purposes of both these treaties, Article 6 will apply and, given that the immovable property is located in State L2, State L2 will be entitled to impose tax on the income.

The losing residence state of the recipient (State L1): State L1 will be subject to the conditions of the W1-L1 treaty. For the purposes of this treaty Article 6 will not apply because the immovable property is not located in State L1. Instead, Article 7 or Article 21 will apply (depending on whether the income is considered to be business profits) and State L1 will be prevented from imposing tax on the income.

The winning residence state of the recipient (State W1): State W1 must apply the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax but will have an obligation to provide relief (either exemption or credit) under the W1-L2 treaty. State W1 will not have a relief obligation under either the W1-W2 treaty or the W1-L1 treaty because the terms of those treaties do not allow State W2 or State L1, respectively, to impose any tax on the income.

Overview: In this situation, tax is imposed in the where the property is located (State L2) and in State W1, and State W1 will have an obligation to provide relief. State W2 and State L1 are both prevented from imposing tax on the income. In this situation State W2 and State L2 are both subject to multiple treaty conditions in respect of the same income, however this is unlikely to have any practical impact in those states. State W2 (the state where the property is located) would generally be entitled to impose tax under both treaties and State L2 (where the property is not located) would generally be prevented from imposing tax under both treaties. Nevertheless, there may be situations where the terms of the two applicable treaties do differ in a way that impacts on one of the source states’ taxing rights.

4.6.2. Application of proposed solutions

The winning residence state of the payor (State W2): State W2 must continue to apply the conditions of the W1-W2 treaty but no longer has to apply the L1-W2 treaty. This is unlikely to have any practical impact, however, since State W2 will continue to be prevented from imposing tax under either Article 7 or Article 21 of the W1-W2 treaty. Article 6 will not apply because the immovable property is not located in State W2.

The losing residence state of the payor (State L2): State L2 must continue to apply the conditions of the W1-L2 treaty but no longer has to apply the L1-L2 treaty. Article 6 will continue to apply for the purposes of the W1-L2 treaty and State L2 will be entitled to impose tax on the income.

The losing residence state of the recipient (State L1): State L1 will continue to apply the W1-L1 treaty. Article 6 of the treaty will not apply because the immovable property is not located in State L1. Instead, Article 7 or Article 21 will apply (depending on whether the income is considered to be business profits) and State L1 will be prevented from imposing tax on the income.

The winning residence state of the recipient (State W1): State W1 must continue to apply the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax but will be obliged to provide relief (either credit or exemption) under the W1-L2 treaty. State W1 will not be obliged to provide relief under the W1-W2 treaty or the W1-L1 treaty, since both State W2 and State L1 are prevented from imposing tax.

Overview: The source states will now be subject only to the conditions of their respective treaties with State W1 and will no longer be obliged to apply the conditions of their treaties with State L1. This means they are no longer subject to multiple treaty conditions in respect of the same income and also addresses the risk of improper use of the treaties between the losing residence state and the source states. Note that the fact that the payor is no longer considered resident in State L2 for treaty purposes has no impact in this situation, since the residence of the payor has no influence on the source state’s taxing rights in relation to income from immovable property.

4.7. 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.1638

This section deals with a situation where a dual resident person, resident in State W1 and in State L1, derives income from shipping, inland waterways transport and/or air transport from outside those two states. The income is also paid by a dual resident, a person who is resident in State W2 and in State L2. The place of effective management of the recipient of the income is located in State W1 and that person’s residence is thus assigned to State W1 under the tie-breaker provision of the W1-L1 treaty. The residence of the payor is assigned to State W2 under the tie-breaker provision of the W2-L2 treaty. This situation is illustrated in the following diagram (in which “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 10 (Section 10.4.). For a more detailed discussion of reverse dual resident triangular cases, refer to Chapter 12 (Section 12.3.).

4.7.1. Existing treaty framework

The winning residence state of the payor (State W2): State W2 must apply the conditions of both the W1-W2 treaty and the L1-W2 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 W1-W2 treaty it is quite clear that, since the place of effective management is located in State W1, State W2 will be prevented from imposing tax on the income. For the purposes of the L1-W2 treaty, however, the place of effective management is located in a third state and it is therefore unclear how Article 8 should be applied. In any case, this will not have any practical impact since State W2 is already prevented from imposing tax under the W1-W2 treaty.

The losing residence state of the payor (State L2): State L2 must apply the conditions of both the W1-L2 treaty and the L1-L2 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 W1-L2 treaty it is quite clear that, since the place of effective management is located in State W1, State L2 will be prevented from imposing tax on the income. For the purposes of the L1-L2 treaty, however, the place of effective management is located in a third state and it is thus unclear how Article 8 should be applied.1639 In any case, this will not have any practical impact since State L2 is already prevented from imposing tax under the W1-L2 treaty.

1638 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.).

1639 This is discussed further in Chapter 2 (see Section 2.7.).
The losing residence state of the recipient (State L1): State L1 must apply the conditions of the W1-L1 treaty. For the purposes of this treaty, Article 8 will apply and the income may only be taxed in State W1, i.e., the state where the place of effective management is located. State L1 will thus be prevented from imposing any tax on the income.

The winning residence state of the recipient (State W1): State W1 must apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax on the income and, since all the other states are prevented from imposing tax under their respective treaties with State W1, State W1 will have no obligation to provide relief.

Overview: In this situation, tax may only be imposed in State W1, since all the other states involved will be prevented from imposing tax under Article 8 of their respective treaties with State W1. One issue which arises in this situation is that the source states, State W2 and State L2, will be bound by multiple treaty conditions in respect of the income. 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 L1 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.

4.7.2. Application of proposed solutions

The winning residence state of the payor (State W2): State W2 must continue to apply the conditions of the W1-W2 treaty but no longer has to apply the L1-W2 treaty. This is unlikely to have any practical impact, however, since State W2 will continue to be prevented from imposing tax under Article 8 of the W1-W2 treaty.

The losing residence state of the payor (State L2): State L2 must continue to apply the conditions of the W1-L2 treaty but no longer has to apply the L1-L2 treaty. Again, this is unlikely to have any practical impact since State L2 will continue to be prevented from imposing tax under Article 8 of the W1-L2 treaty.

The losing residence state of the recipient (State L1): State L1 will continue to apply the W1-L1 treaty. For the purposes of this treaty, Article 8 will apply and State L1 will be prevented from imposing any tax on the income.

The winning residence state of the recipient (State W1): State W1 must continue to apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax on the income and, since all the other states are prevented from imposing tax under their respective treaties with State W1, State W1 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 W1 and will no longer be obliged to apply the conditions of their treaties with State L1. 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 W2 and State L2 will continue to be prevented from imposing tax under their respective treaties with State W1. Nevertheless, this does resolve the uncertain application of Article 8 of the treaties between State L1 and the source states, since these treaties no longer apply. Note that the fact that the payor is no longer considered resident in State L2 for treaty purposes has no impact in this situation, since the residence of the payor has no influence on the source state’s taxing rights in relation to income dealt with under Article 8.

4.8. Capital gains from the alienation of immovable property

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

“Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.”
Thus, Article 13(1) applies where a resident of one state derives capital gains from the alienation of immovable property located in the other contracting state, and allows the state where the property is located to impose tax on the gain. The reference to Article 6 in Article 13(1) is a reference to the definition of immovable property, which in turn refers to the domestic law of the state where the property is located, as well as containing a list of certain property which is always considered to be immovable property for the purposes of the treaty.1640

This section deals with a situation where a dual resident person, resident in State W1 and in State L1, derives a capital gain from the alienation of immovable property located outside those two states. The amount giving rise to the gain is also paid by a dual resident, a person who is resident in State W2 and in State L2. The residence of the person deriving the gain is assigned to State W1 under the tie-breaker provision of the W1-L1 treaty, and the residence of the payor is assigned to State W2 under the tie-breaker provision of the W2-L2 treaty. 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 L2. This situation is illustrated in the following diagram:

For a more detailed discussion of dual resident triangular cases, refer to Chapter 10 (Section 10.4.). For a more detailed discussion of reverse dual resident triangular cases, refer to Chapter 12 (Section 12.3.).

### 4.8.1. Existing treaty framework

**The winning residence state of the payor (State W2):** State W2 must apply the conditions of both the W1-W2 treaty and the L1-W2 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 W2 will be prevented from imposing tax on the gain.1641

**The losing residence state of the payor (State L2):** State L2 must apply the conditions of both the W1-L2 treaty and the L1-L2 treaty. For the purposes of both these treaties, Article 13(1) will apply and State L2 will be entitled to impose tax on the gain.

**The losing residence state of the recipient (State L1):** State L1 must apply the conditions of the W1-L1 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 L1 will be prevented from imposing tax on the gain.

**The winning residence state of the recipient (State W1):** State W1 must apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax, but will be required to provide relief (either exemption or credit) under the W1-L2 treaty (i.e., for tax imposed in the state where the property is located).

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1640 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.).

1641 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). These paragraphs will be discussed in more detail below.
Overview: In this situation, tax may be imposed in the state where the immovable property is located (State L2) and in State W1, and State W1 is obliged to provide relief. This will be either exemption or credit relief, depending on the terms of the treaty. One issue which arises in this situation is that the source states, State W2 and State L2, will be bound by multiple treaty conditions in respect of the capital gain (i.e., their respective treaties with both State W1 and State L1). 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.

4.8.2. Application of proposed solutions

The winning residence state of the payor (State W2): State W2 must continue to apply the conditions of the W1-W2 treaty but no longer has to apply the L1-W2 treaty. This is unlikely to have any practical impact, however, since State W2 will continue to be prevented from imposing tax under Article 13(5) of the W1-W2 treaty.

The losing residence state of the payor (State L2): State L2 must continue to apply the conditions of the W1-L2 treaty but no longer has to apply the L1-L2 treaty. Again, this is unlikely to have any practical impact since State L2 will simply continue to apply Article 13(1) of the W1-L2 treaty, and may continue to impose tax on the gain.

The losing residence state of the recipient (State L1): State L1 will continue to apply the W1-L1 treaty. For the purposes of this treaty, Article 13(5) will apply and State L1 will continue to be prevented from imposing any tax on the gain.

The winning residence state of the recipient (State W1): State W1 must continue to apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax on the gain and, since all the other states are prevented from imposing tax under their respective treaties with State W1, State W1 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 W1 and will no longer be obliged to apply their treaties with State L1. 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 relevant terms of the two treaties. Note that the fact that the payor is no longer considered resident in State L2 for treaty purposes has no impact in this situation, since the residence of the payor has no influence on the source state’s taxing rights in relation to capital gains dealt with under Article 13(1).

4.9. 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 W1 and in State L1, derives a capital gain from the alienation of movable property forming part of the business property of a PE located outside those two states. The amount giving rise to the gain is also paid by a dual resident, a person who is resident in State W2 and in State L2. The residence of the person deriving the gain is assigned to State W1 under the tie-breaker provision of the W1-L1 treaty, and the residence of the payor is assigned to State W2 under the tie-breaker provision of the W2-L2 treaty. In the situation discussed in part of the appendix it is generally assumed that the dual resident does not have a PE in either of the source states, however for the purposes of the discussion in this section, it will be assumed that the movable property forms part of the business property of a PE located in State L2 (i.e., the losing residence state of the payor). This situation is illustrated in the following diagram:
For a more detailed discussion of dual resident triangular cases, refer to Chapter 10 (Section 10.4.). For a more detailed discussion of reverse dual resident triangular cases, refer to Chapter 12 (Section 12.3.).

4.9.1. Existing treaty framework

The winning residence state of the payor (State W2): State W2 must apply the conditions of both the W1-W2 treaty and the L1-W2 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 W2. Instead, Article 13(5) will apply (since none of the other paragraphs of Article 13 apply) and State W2 will be prevented from imposing tax on the capital gain.\textsuperscript{1642}

The losing residence state of the payor (State L2): State L2 must apply the conditions of both the W1-L2 treaty and the L1-L2 treaty. Article 13(2) applies for the purposes of both these treaties and State L2 will be entitled to impose tax on the capital gain.

The losing residence state of the recipient (State L1): State L1 must apply the conditions of the W1-L1 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 L1. Instead, Article 13(5) will apply (since none of the other paragraphs of Article 13 apply) and State L1 will be prevented from imposing tax on the capital gain.

The winning residence state of the recipient (State W1): State W1 must apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax, but will be required to provide relief (either exemption or credit) under the W1-L2 treaty.

Overview: In this situation, tax may be imposed in the state where the PE to which the property belongs is located (State L2) and in State W1, and State W1 is obliged to provide relief (either exemption or credit). State W2 and State L1 are both prevented from imposing tax under their respective treaties with State W1. One issue which arises in this situation is that the source states, State W2 and State L2, will be bound by multiple treaty conditions in respect of the capital gain, i.e., their respective treaties with both State W1 and State L1. 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.

4.9.2. Application of proposed solutions

The winning residence state of the payor (State W2): State W2 must continue to apply the conditions of the W1-W2 treaty but no longer has to apply the L1-W2 treaty. This is unlikely to have any practical impact, however, since State W2 will continue to be prevented from imposing tax under Article 13(5) of the W1-W2 treaty.

The losing residence state of the payor (State L2): State L2 must continue to apply the conditions of the W1-L2 treaty but no longer has to apply the L1-L2 treaty. Again, this is unlikely to have any practical impact.

\textsuperscript{1642} 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). These paragraphs will be discussed in more detail below.
since State L2 will simply continue to apply Article 13(2) of the W1-L2 treaty and may still impose tax on the gain.

The losing residence state of the recipient (State L1): State L1 will continue to apply the W1-L1 treaty. For the purposes of this treaty, Article 13(5) will apply and State L1 will be prevented from imposing any tax on the gain.

The winning residence state of the recipient (State W1): State W1 must continue to apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax, but will be required to provide relief (either exemption or credit) under the W1-L2 treaty. State W1 will have no obligation to provide relief under either the W1-W2 treaty or the W1-L1 treaty, since both State W2 and State L1 are prevented from imposing tax on the gain.

Overview: The source states will now be subject only to the conditions of their respective treaties with State W1 and will no longer be obliged to apply their treaties with State L1. 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 fact that the payor is no longer considered resident in State L2 for treaty purposes has no impact in this situation, since the residence of the payor has no influence on the source state’s taxing rights in relation to capital gains dealt with under Article 13(2).

4.10. 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 W1 and in State L1, derives a capital gain from the alienation of ships, aircraft and/or associated assets. The amount giving rise to the gain is paid by a resident of State W2 and originate from a PE of the payor located in State L2. The place of effective management of the person deriving the capital gain is located in State W1 and consequently, the residence of the dual resident person is assigned to State W1 for the purposes of the treaty between the two residence states. The residence of the dual resident payor is assigned to State W2 under the tie-breaker provision of the W2-L2 treaty. This situation is illustrated in the following diagram:

For a more detailed discussion of dual resident triangular cases, refer to Chapter 10 (Section 10.4.). For a more detailed discussion of reverse dual resident triangular cases, refer to Chapter 12 (Section 12.3.).

4.10.1. Existing treaty framework

The winning residence state of the payor (State W2): State W2 must apply the conditions of both the W1-W2 treaty and the L1-W2 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 W1-W2 treaty it is quite clear that, since the place of effective management is located in State W1, State W2 will be prevented from imposing tax on the gain. For the purposes of the L1-W2 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 is not likely to have any practical impact, since State W2 is already prevented from imposing tax under the W1-W2 treaty.

The losing residence state of the payor (State L2): State L2 must apply the conditions of both the W1-L2 treaty and the L1-L2 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 W1-L2 treaty it is quite clear that, since the place of effective management is located in State W1, State L2 will be prevented from imposing tax on the gain. For the purposes of the L1-L2 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 is not likely to have any practical impact because State L2 is already prevented from imposing tax under the W1-L2 treaty.

The losing residence state of the recipient (State L1): State L1 must apply the conditions of the W1-L1 treaty. For the purposes of this treaty, Article 13(3) will apply and State L1 will be prevented from imposing any tax on the gain.

The winning residence state of the recipient (State W1): State W1 must apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax on the gain and, since all the other states are prevented from imposing tax under their respective treaties with State W1, State W1 will have no obligation to provide relief.

Overview: In this situation, tax may only be imposed in State W1; all the other states involved will be prevented from imposing tax under Article 13(3) of their respective treaties with State W1. One issue which arises in this situation is that the source states, State W2 and State L2, will be bound by multiple treaty conditions in respect of the capital gain (i.e., their respective treaties with both State W1 and State L1). 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 L1 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.

4.10.2. Application of proposed solutions

The winning residence state of the payor (State W2): State W2 must continue to apply the conditions of the W1-W2 treaty but no longer has to apply the L1-W2 treaty. This is unlikely to have any practical impact, however, since State W2 will continue to be prevented from imposing tax under Article 13(3) of the W1-W2 treaty.

The losing residence state of the payor (State L2): State L2 must continue to apply the conditions of the W1-L2 treaty but no longer has to apply the L1-L2 treaty. Again, this is unlikely to have any practical impact since State L2 will continue to be prevented from imposing tax under Article 13(3) of the W1-L2 treaty.

The losing residence state of the recipient (State L1): State L1 will continue to apply the W1-L1 treaty. For the purposes of this treaty, Article 13(3) will apply and State L1 will be prevented from imposing any tax on the gain.

The winning residence state of the recipient (State W1): State W1 must continue to apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax on the gain and, since all the other states are prevented from imposing tax under their respective treaties with State W1, State W1 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 W1 and will no longer be obliged to apply their treaties with State L1. 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 W2 and State L2 will continue to be prevented from imposing tax under their respective treaties with State W1. Nevertheless, this does resolve the uncertainty regarding the application of Article 13(3) of the treaties between State L1 and the source states, since these treaties no longer apply. Note that the fact that the payor is no longer considered resident in State L2 for treaty purposes has no

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1643 This is discussed further in Chapter 2 (see Section 2.7.).
impact in this situation, since the residence of the payor has no influence on the source state’s taxing rights in relation to capital gains dealt with under Article 13(3).

4.11. 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 capital gains from the alienation of shares, but some concluded treaties also allow source based taxation of gains arising from:

3. The alienation of shares in a company having more than 50% of its assets located in the source state;\(^{1644}\) and/or
4. 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.\(^ {1645}\)

In general, where such provisions exist, they 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, resident in State W1 and in State L1, 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 amount giving rise to the gain is also paid by a dual resident, a person who is resident in State W2 and in State L2. The residence of the person deriving the gain is assigned to State W1 under the tie-breaker provision of the W1-L1 treaty, and the residence of the payor is assigned to State W2 under the tie-breaker provision of the W2-L2 treaty. For the purposes of the discussion below, it will generally be assumed that the underlying immovable property is located in State L2. This situation is illustrated in the following diagram:

![Diagram](image)

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 10 (Section 10.4.). For a more detailed discussion of reverse dual resident triangular cases, refer to Chapter 12 (Section 12.3.).

4.11.1. Existing treaty framework

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\(^ {1645}\) See, for example the reservations of France, Chile, Sweden and Korea in the OECD Commentary to Article 13 of the OECD Model.
The winning residence state of the payor (State W2): State W2 must apply the conditions of both the W1-W2 treaty and the L1-W2 treaty. Article 13(4) will not apply for the purposes of either of these treaties because the underlying property is not located in State W2. Instead, since none of the other paragraphs of Article 13 apply, Article 13(5) will apply and State W2 will be prevented from imposing any tax on the gain.1646

The losing residence state of the payor (State L2): State L2 must apply the conditions of both the W1-L2 treaty and the L1-L2 treaty. For the purposes of both these treaties, Article 13(4) will apply and State L2 may impose tax on the gain.

The losing residence state of the recipient (State L1): State L1 must apply the conditions of the W1-L1 treaty. For the purposes of this treaty, Article 13(4) will not apply because the underlying property is not located in State L1. Instead, since none of the other paragraphs of Article 13 apply, Article 13(5) will apply and State L1 will be prevented from imposing any tax on the gain.

The winning residence state of the recipient (State W1): State W1 must apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax on the gain, but will be obliged to provide relief for tax imposed in State L2 under the W1-L2 treaty. State W1 will not have any relief obligation under the W1-W2 treaty or the W1-L1 treaty because both State W2 and State L1 are prevented from imposing tax under their respective treaties with State W1.

Overview: In this situation, tax may be imposed in State W1 and in State L2 and State W1 will be obliged to provide relief. One issue which arises in this situation is that the source states, State W2 and State L2, will be bound by multiple treaty conditions in respect of the capital gain (i.e., their respective treaties with both State W1 and State L1). 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.

4.11.2. Application of proposed solutions

The winning residence state of the payor (State W2): State W2 must continue to apply the conditions of the W1-W2 treaty but no longer has to apply the L1-W2 treaty. This is unlikely to have any practical impact, however, since State W2 will continue to be prevented from imposing tax under Article 13(5) of the W1-W2 treaty. Article 13(4) will not apply because the underlying immovable property is not located in State W2.

The losing residence state of the payor (State L2): State L2 must continue to apply the conditions of the W1-L2 treaty but no longer has to apply the L1-L2 treaty. Again, this is unlikely to have any practical impact since State L2 will continue to apply Article 13(4) of the W1-L2 treaty and may still impose tax on the gain.

The losing residence state of the recipient (State L1): State L1 will continue to apply the W1-L1 treaty. For the purposes of this treaty, Article 13(4) will not apply because the underlying property is not located in State L1. Instead, Article 13(5) will apply and State L1 will be prevented from imposing any tax on the gain.

The winning residence state of the recipient (State W1): State W1 must continue to apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax on the gain and must provide relief in accordance with the W1-L2 treaty. State W1 will have no obligation to provide relief under either the W1-W2 treaty or the W1-L1 treaty since both State W2 and State L1 are prevented from imposing any tax under their respective treaties with State W1.

Overview: The source states will now be subject only to the conditions of their respective treaties with State W1 and will no longer be obliged to apply their treaties with State L1. 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

1646 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).
have any practical impact since State W2 will continue to be entitled to impose tax under its treaty with State W1 and State L2 will continue to be prevented from imposing tax under its treaty with State W1. It could nevertheless have an impact if the relevant conditions of the treaties differ. Note that the fact that the payor is no longer considered resident in State L2 for treaty purposes has no impact in this situation, since the residence of the payor has no influence on the source state’s taxing rights in relation to capital gains dealt with under Article 13(4).

4.12. Capital gains from the alienation of other property

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

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

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

This section deals with a situation where a dual resident person, resident in State W1 and in State L1, derives a capital gain from the disposal of other property from outside those two states. The amount giving rise to the gain is also paid by a dual resident, a person who is resident in State W2 and in State L2. The residence of the person deriving the gain is assigned to State W1 under the tie-breaker provision of the W1-L1 treaty, and the residence of the payor is assigned to State W2 under the tie-breaker provision of the W2-L2 treaty. This situation is illustrated in the following diagram:

For a more detailed discussion of dual resident triangular cases, refer to Chapter 10 (Section 10.4.). For a more detailed discussion of reverse dual resident triangular cases, refer to Chapter 12 (Section 12.3.).

4.12.1. Existing treaty framework

The winning residence state of the payor (State W2): State W2 must apply the conditions of both the W1-W2 treaty and the L1-W2 treaty. For the purposes of both these treaties, Article 13(5) will apply and State W2 will be prevented from imposing tax on the gain.

The losing residence state of the payor (State L2): State L2 must apply the conditions of both the W1-L2 treaty and the L1-L2 treaty. For the purposes of both these treaties, Article 13(5) will apply and State L2 will be prevented from imposing tax on the gain.

The losing residence state of the recipient (State L1): State L1 must apply the conditions of the W1-L1 treaty. For the purposes of this treaty, Article 13(5) will apply and State L1 will be prevented from imposing tax on the gain.

The winning residence state of the recipient (State W1): State W1 must apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax on the gain. Since State W2, State L2 and State L1 are all prevented from imposing tax under their respective treaties with State W1, State W1 will have no obligation to provide relief.

Overview: In this situation, tax may only be imposed in State W1. One issue which arises in this situation is that the source states, State W2 and State L2, will be bound by multiple treaty conditions in respect of the capital gain (i.e., their respective treaties with both State W1 and State L1). 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.

4.11.2. Application of proposed solutions

The winning residence state of the payor (State W2): State W2 must continue to apply the conditions of the W1-W2 treaty but no longer has to apply the L1-W2 treaty. This is unlikely to have any practical impact, however, since State W2 will continue to be prevented from imposing tax under Article 13(5) of the W1-W2 treaty.

The losing residence state of the payor (State L2): State L2 must continue to apply the conditions of the W1-L2 treaty but no longer has to apply the L1-L2 treaty. Again, this is unlikely to have any practical impact since State L2 will continue to be prevented from imposing any tax under Article 13(5) of the W1-L2 treaty.

The losing residence state of the recipient (State L1): State L1 will continue to apply the W1-L1 treaty. For the purposes of this treaty, Article 13(5) will apply and State L1 will be prevented from imposing any tax on the gain.

The winning residence state of the recipient (State W1): State W1 must continue to apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax on the gain and will have no obligation to provide relief since State W2, State L2 and State L1 are all prevented from imposing any tax under their respective treaties with State W1.

Overview: The source states will now be subject only to the conditions of their respective treaties with State W1 and will no longer be obliged to apply their treaties with State L1. This means they are no longer subject to multiple treaty conditions in respect of the same capital gain, however this is unlikely to have any practical impact since they will both continue to be prevented from imposing tax under their respective treaties with State W1. Note that the fact that the payor is no longer considered resident in State L2 for treaty purposes has no impact in this situation, since the residence of the payor has no influence on the source state’s taxing rights in relation to capital gains dealt with under Article 13(5).

4.13. 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 W1 and in State L1, receives other income from outside those two states. The income is also paid by a dual resident, a person resident in State W2 and State L2. The residence of the person deriving the gain is assigned to State W1 under the tie-breaker provision of the W1-L1 treaty, and the residence of the payor is assigned to State W2 under the tie-breaker provision of the W2-L2 treaty. This situation is illustrated in the following diagram:
For a more detailed discussion of dual resident triangular cases, refer to Chapter 10 (Section 10.4.). For a more detailed discussion of reverse dual resident triangular cases, refer to Chapter 12 (Section 12.3.).

4.13.1. Existing treaty framework

The winning residence state of the payor (State W2): State W2 must apply the conditions of both the W1-W2 treaty and the L1-W2 treaty. For the purposes of both these treaties, Article 21 will apply and State W2 will be prevented from imposing tax on the income.

The losing residence state of the payor (State L2): State L2 must apply the conditions of both the W1-L2 treaty and the L1-L2 treaty. For the purposes of both these treaties, Article 21 will apply and State L2 will be prevented from imposing tax on the income.

The losing residence state of the recipient (State L1): State L1 must apply the conditions of the W1-L1 treaty. For the purposes of this treaty, Article 21 will apply and State L1 will be prevented from imposing tax on the income.

The winning residence state of the recipient (State W1): State W1 must apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax on the income and, since State W2, State L2 and State L1 are all prevented from imposing tax under their respective treaties with State W1, State W1 will have no obligation to provide relief.

Overview: In this situation, tax may only be imposed in State W1 and State W1 will therefore have no relief obligation. One issue which arises in this situation is that the source states, State W2 and State L2, will be bound by multiple treaty conditions in respect of the income (i.e., their respective treaties with both State W1 and State L1). 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.

4.13.2. Application of proposed solutions

The winning residence state of the payor (State W2): State W2 must continue to apply the conditions of the W1-W2 treaty but no longer has to apply the L1-W2 treaty. This is unlikely to have any practical impact, however, since State W2 will continue to be prevented from imposing tax under Article 21 of the W1-W2 treaty.

The losing residence state of the payor (State L2): State L2 must continue to apply the conditions of the W1-L2 treaty but no longer has to apply the L1-L2 treaty. Again, this is unlikely to have any practical impact since State L2 will continue to be prevented from imposing any tax under Article 21 of the W1-L2 treaty.

The losing residence state of the recipient (State L1): State L1 will continue to apply the W1-L1 treaty. For the purposes of this treaty, Article 21 will apply and State L1 will be prevented from imposing any tax on the income.

The winning residence state of the recipient (State W1): State W1 must continue to apply the conditions of the W1-W2 treaty, the W1-L2 treaty and the W1-L1 treaty. State W1 may impose tax on the gain and will have no obligation to provide relief since State W2, State L2 and State L1 are all prevented from imposing any tax under their respective treaties with State W1.

Overview: The source states will now be subject only to the conditions of their respective treaties with State W1 and will no longer be obliged to apply their treaties with State L1. This means they are no longer subject to multiple treaty conditions in respect of the same income, however this is unlikely to
have any practical impact since they will both continue to be prevented from imposing tax under their respective treaties with State W1. Note that the fact that the payor is no longer considered resident in State L2 for treaty purposes has no impact in this situation, since the residence of the payor has no influence on the source state’s taxing rights in relation to income dealt with under Article 21.

4.14. Conclusions

This section has discussed a situation where a dual resident triangular case is combined with a reverse dual resident triangular case. The analysis above illustrates that the issues arising in this situation are generally the same as those arising in the basic triangular cases which it comprises. Reverse dual resident triangular cases only give rise to dual source-based taxation in relation to dividends and interest (and royalties where the applicable treaties differ from the OECD Model) and thus, dual source based taxation may only occur here where dividends, 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 10).

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. This 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.

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

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 dual resident 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.