RELEVANT ASPECTS OF TRIANGULAR SITUATIONS: AN ADDITIONAL PERSPECTIVE

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SOME RELEVANT ASPECTS OF TRIANGULAR SITUATIONS: AN ADDITIONAL PERSPECTIVE

Executive Summary

The world is rapidly approaching towards a global economy. More than ever any kind of commercial and political relationships for a common development have been concluded by the countries to stand out in the competitive economic world.

As a consequence, the interaction of countries has become more evident, including not only relationships between two States but among several countries. This situation has led the members of the international community to improve their cross-border economic and taxation policies through the conclusion of tax treaties for the avoidance of double taxation.

A number of problems arise when more than two States are involved in what has been referred as *triangular situations,* in which certain issues arise in order to determine the taxing powers of the countries involved, the tax relieves to be granted by such States, the determination of the source of the income, the alleviation of double or even triple taxation, and some other issues.

In the tax world it exists what has been called "typical triangular cases" and what is referred in this paper as "atypical triangular cases". A great diversity of these cases already have occurred in practice and have reached the field of analysis of taxpayers, tax authorities, tax courts and tax practitioners.

The purpose of this LLM paper is to provide an additional stand point of the analysis already given on this subject. By means of this paper, an overall study is presented in which several aspects of triangular situations are commented.

Commencing from the background of the causes giving raise to triangular cases, an analysis is made upon the bilateral basis on which tax treaties are concluded, their scope and their application to persons resident in the Contracting States, without being applicable to permanent establishments for not being "persons".

The main purpose of the tax treaties for the avoidance of international juridical double taxation is analyzed through the methods of exemption and credit methods.

Additionally, a general but not exhaustive description of cases of triangular nature is effected, in which the typical triangular situations and also some atypical triangular situations are described. Their principal consequences and the specific problems arising from their occurrence are also described and analyzed.

Once the principal issues arising from the typical triangular situations are identified, some comments are made upon the problems still pending to be clearly solved, such as the scope and interpretation of the permanent establishment non-discrimination and the freedom of establishment provision in the European Union. As well, some comments are done regarding the treaty shopping and the tax avoidance problem.

The problems arising from atypical triangular cases are identified and specific cases of dual residence are analyzed (application of Article 4 of the Model Convention). Some other atypical cases are presented, such as a case of income from employment received by an employee performing services in a deemed offshore permanent establishment (interpretation of Article 15 of the Model Convention) and another case of profits from international transportation (application of Article 8 of the Model Convention). Finally, an atypical triangular case of income derived by artistes and sportsmen that is accrued by a legal entity resident in a third State is also analyzed.

Some solutions already proposed and cases decided by courts around the world are briefly analyzed and commented.

In the last chapter of the paper some alternatives of solution are proposed both for the typical case commented and for the atypical cases commented. These practical alternatives of solution may provide ideas as a commencement for a future development of triangular situations and to provide certainty to taxpayers, tax advisers and tax courts.

The alternatives of solution stated in this paper may constitute difficult options to be implemented, however, they may represent reasonable solutions for a subject that is becoming each time more relevant within the international business and tax community, same community that still has to say several things about this subject of triangular cases.

SOME RELEVANT ASPECTS OF TRIANGULAR SITUATIONS: AN ADDITIONAL PERSPECTIVE

Overview of Main Findings

Once the background and principal characteristics giving rise to typical and atypical triangular cases has been analyzed, the following are the main findings accomplished with the present paper:

1.- Tax treaties are agreements concluded on a bilateral basis mainly for the avoidance of double taxation which are applicable only to the parties involved in the treaty-making process. Such treaties only apply to persons and cannot be applied to permanent establishments.

2.- Typical triangular cases arise when payments of dividends, interest and royalties are done to a resident and attributed to a permanent establishment. Several issues not yet clearly solved come up from these cases.

3.- There are several types of atypical triangular cases in which different problems arise. This type of situations arise in cases such as dual resident cases, when income from employment in which an offshore permanent establishment provision applies, in cases of profits from international transportation and in cases of income derived by artistes and sportsmen.

4.- Although some solutions have been proposed by scholars and some decisions have been issued by some courts around the world, it is difficult to propose a general solution for triangular situations.

5.- A solution is proposed with respect to typical triangular situations in which upon the existence and recognition of a triangular situation, the non-discrimination clause of the treaty between the State of residence and the State in which the permanent establishment is situated is applicable, bringing as consequence the tax treatment of such permanent establishment as a resident for purposes of treaties with third parties.

6.- With respect to atypical triangular situations, in the case of dual residents, the recognition of a triangular situation must take place and therefore the treaty between the Winner State and the State of source (in the case of dual resident as recipient) and the treaty between the Winner State and the State of the recipient (in the case of a dual resident as payor) should apply.

7.- In the case of income from employment in which a permanent establishment offshore provision exists, the State considered as fictitious permanent establishment may perform bilateral negotiations to make prevail the offshore provision over the provisions of other applicable treaties.

8.- Regarding the profits from international transportation, once again the recognition of a triangular situation in accordance with a definition either contained in the Commentary or in the Model Convention should be recognized, situation that could permit the States in which the place of effective management of a company is located to negotiate with other States the reservation of a right to tax, provided, of course that a triangular situation takes place.

9.- Finally, pursuant the case of income derived by artistes and sportsmen, no concrete solution could be given but just to propose that either the Commentary or the Model Convention provides for a more certain application on the interpretation of Article 17(2) of the Model Convention in triangular situations, interpretation that may depend on the domestic law of the participating States.

Although there are reasonable legal basis for these bilateral alternatives of solution to succeed, their implementation of any of these bilateral alternatives of solution may be complicated and their viability must be analyzed under several circumstances.

However, scholars, practitioners and courts must keep on studying and developing solutions and ideas for the future solution and interpretation of this kind of cases that have become an important topic in the international tax and business community.

SOME RELEVANT ASPECTS OF TRIANGULAR SITUATIONS: AN ADDITIONAL PERSPECTIVE

Introduction

The accelerated integration of the world and the economic cooperation is notably growing before the eyes of the countries forming part of the international community. Today, more than ever, any sort of commercial and political relationships for a common and sustained development have been entered into by countries purporting to stand out in the current competitive economic world.

One good example of such sort of agreements are the ones which gave rise to the General Agreement on Tariffs and Trade (GATT), the European Union (EU) and the North America Free Trade Agreement (NAFTA), where the countries involved are contributing with their best efforts for a joint development of capacities in the every time more globalised world.

As a direct consequence of these type of agreements, the interaction of countries has become more evident, including not only relationships and transactions between two States but among several countries. This situation has forced the members of the international community to improve their cross-border economic and taxation policies, mainly through the adoption of tax treaties for the avoidance of double taxation.

Such treaties are generally signed under a bilateral basis, namely between two States, arising thus a number of problems when more than two States are involved in what has been largely referred to as *triangular situations.* The general feature of these triangular situations is that each one of the States involved is claiming rights and obligations under its own treaties, giving rise to certain problems regarding the the interaction of the application of such tax treaties.

The problems arising from these situations basically refer to the taxing powers of the States concerned, to the tax relieves to be granted by such States, to the determination of the source of the income, to the alleviation of double or even triple taxation, and some others.

Many of these problems have not been consciously and in depth foreseen at the moment in which model conventions have been drafted nor at the moment in which the States have entered into bilateral negotiations for the avoidance of double taxation, becoming such problems more relevant through the practical experience of taxpayers, tax authorities and certainly, of tax advisers.

Due to the necessity of companies to expand their commercial activities throughout different economies in the global economy and to the practical importance of the above referred problems, the purpose of the research to be done through this LLM paper is to provide an additional stand point of the tax treaties for the avoidance of double taxation in triangular situations by means of following the next steps:

i) Through the elaboration of a general background of the causes and motives that have given raise to triangular situations, bearing in mind for this purpose the scope of tax treaties.

ii) Through the analysis of a general frame of situations from which ordinary and extraordinary triangular cases may be originated, with the corresponding analysis of some general and specific problems arising from such triangular situations.

iii) Through the brief study of some bilateral and not trilateral proposals of solution to the problems arising from the application of treaties in triangular situations.

Although there are several studies already done on specific triangular situations, the present work pretends to be one step ahead and provide an overall view of the background, problematic and solutions surrounding the different types of triangular situations arising in the day to day practice. Indeed, one of the main purposes of this LLM paper is to provide an additional perspective of the interaction of treaties in triangular situations from a practical point of view.

It has to be pointed out that this paper does not intend to be an exhaustive analysis of triangular situations. In fact, in addition to the typical and atypical triangular situations analyzed and studied in terms of this paper, many other triangular situations may be discussed and surely numerous new ideas may be developed and many things can still be said about this topic that is beginning to have a really significant relevance within the international tax community.

Some Relevant Aspects of Triangular Situations: An Additional Perspective

CHAPTER 1

The Scope of Tax Treaties

1.1. Agreements concluded on a bilateral basis

One of the main general objectives of a tax treaty is to facilitate cross-border trade and investment transactions through the exchange of goods and services and the movement of capital and persons among countries by eliminating or at least reducing tax impediments as barriers to international commerce such as the alleviation of double taxation.

Pursuant to Article 2(a) of the Vienna Convention[1], a "treaty" is an international written agreement concluded among States as sovereign nations and regulated by international law. In accordance with Section f) of the same provision, a "Contracting State" shall be a State that has agreed in obliging itself in terms of the treaty, namely a contracting party to a certain convention.

In connexion with the above referred provisions, a declaration of the will of a contracting State expressed in a treaty can be signed between two or more independent nations as parties to a certain agreement willing to be bound by the corresponding terms and conditions to be accorded. However, as a consequence of the traditional approach adopted by the Organization of Economic Cooperation and Development (hereinafter referred to as the OECD) following the last League of Nations Draft Conventions, regarding tax treaties it has been a general accepted practice that individual States enter into bilateral agreements for the avoidance of double taxation and just a few conventions for this purpose have been concluded under multilateral agreements.[2]

Therefore, the agreements between independent States solely apply to the two Contracting States concerned that decided to oblige themselves in terms of the provisions negotiated and afterwards agreed. Such an agreement will only be applicable to the two parties involved as a bilateral relationship[3] without

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1 Vienna Convention on the Law of Treaties concluded in Vienna, 23 May 1969, which is a codification of general international law on treaties that has been largely regarded as customary international law.

2 In this regard, a Scandinavian multilateral agreement has been signed by Denmark, Norway, Sweden, Finland and Iceland.

3 This means that the tax treaties concluded under a bilateral basis will only apply to a resident of one Contracting State who either receives income from the other Contracting State or who owns assets

being applicable to third States referred or involved with a certain transaction[4], situation that gives raise to question the classical approach of double tax treaties and originates the necessity to adapt the traditional bilateral approach to cases involving more than two States with the same kind of income.

This perspective of restricted application of tax treaties is the prevailing point of view in international tax law which has given rise to the principle of relative effect of international treaties, in which the treaties should only produce effects between the Contracting States and there should be no effect for third countries that did not participate in the treaty-making process.[5]

1.2. APPLICATION OF TAX TREATIES ONLY TO TAX RESIDENTS

The personal scope of the tax treaties is limited in terms of Article 1 of the Model Convention[6] to the persons who are residents of one or both of the Contracting States (treaty subject). The term "person" is covered by the general definitions of Article 3 of the Model Convention and includes individuals, companies and other body of persons.

A "resident" is defined in broad terms by Article 4 of the same Model Convention with reference to the person who under the laws of a certain State is liable to tax by several nexus criteria (domicile, residence, place of management and other similar criterion) with such State, excluding any person liable to tax in the same State with respect to income exclusively from sources in that State.

In accordance with the aforementioned provisions, a permanent establishment is excluded from the personal scope of application of the tax conventions and as such do not enjoy the benefits of treaties for not being a "person" under the definition of Article 3 of the Model Convention.

1.2.1. Personalization of permanent establishments

A permanent establishment is a legal fiction created for tax purposes by the international tax legislation upon which a person resident in one State actively participates in the economic life of another State to such extent that it becomes within the tax jurisdiction of this second State. Several legal and mainly tax

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situated in the other State. In this regard, it is also applicable the principle of *"pacta sunt servanda"* envisaged by Article 26 of the Vienna Convention.

[4] It has been sustained that *"...by definition, tax treaties are normally bilateral in nature and therefore cannot effectively deal with multilateral situations"*. Marco Lombardi, "Triangular Situations: A Case of Double Source Taxation of Interest and Royalties", *IBFD Bulletin* (April, 1997), 177-182, at 177. In connexion with this, Article 34 of the Vienna Convention establishes that a treaty does not create obligations nor rights for a third State unless such State agrees on said obligations.

[5] Adolfo J. Martín Jiménez, F. Alberto García Prats and José M. Calderón Carrero, "Triangular Cases, Tax Treaties and EC Law: The *Saint-Gobain* Decision of the ECJ", *IBFD Bulletin* (June 2001), 241-253, at 245.

[6] All the references made to the Model Convention in this LLM Paper, unless otherwise indicated, are deemed to be made to the 1977 OECD Model Tax Convention on Income and Capital, including the amendments effected up to the year 2003.

consequences (attribution of taxable income to the activities performed) are attributed to this legal fiction by the legislation of the States integrating the international tax community.

The concept of a permanent establishment involves only one person and as such subject to the benefits of a tax convention, but with an economic involvement due to several criteria[7] in the economic activities of another State, without enjoying of the benefits of a certain tax convention in this latter State for not being a person, as previously mentioned.

Notwithstanding that permanent establishments are indeed not considered as persons for purposes of the tax treaties in terms of Article 1 of the Model Convention, such permanent establishments are not only taxed on a territorial basis, namely on the income derived only in the country in which they are situated, but also on the effectively-connected income, implying thus to attribute to permanent establishments the income derived by a nonresident or entity through those permanent establishments.[8]

This tax approach has meant the "personalization" of the permanent establishment taxation, but such personal approach has not been accompanied by extending to the permanent establishment several measures to mitigate or eliminate double taxation with respect to cross-border transactions,[9] situation that has introduced new questions with respect to the international tax debate in regard to the functions attributed to the States by double tax treaties and also to the subjective scope of such tax treaties and the adaptation of this latter conventions to the cases involving more than two countries in a certain cross-border transaction.[10]

CHAPTER 2

Purpose of tax treaties

2.1. Avoidance of double taxation

As mentioned before, one of the main objectives of tax treaties is to avoid international juridical[11] double taxation arising in cases where the same person is taxed in respect of the same object by two different jurisdictions.

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[7] The situations under which a permanent establishment of a resident of one State is created in another State are covered by Article 5 of the Model Convention.

[8] See Adolfo J. Martín Jiménez, F., F. Alberto García Prats and José M. Calderón Carrero, supra note 5, at 241. In this case, the taxpayer will be deemed to be present for tax purposes in two different States.

[9] *Ibidem*, at 241 and 242.

[10] Francisco Alfredo García Prats, "Triangular Cases and Residence as a Basis for Alleviating International Double Taxation. Rethinking the Subjective Scope of Double Tax Treaties", 11 *Intertax* (1994), 474.

[11] Although economic double taxation also exists when the same income is taxed twice to different persons, as it is the case of profit distributions, tax treaties do not deal with such cases of double taxation.

In this regard, it is important to note that the residence of a taxpayer establishes a relationship between a country and the taxpayer who derives the income. Such residents will be taxed on their worldwide income. On the other hand, income tax is also levied by a country on domestic income of nonresidents. These principles are referred to respectively as the residence and source principles of taxation.[12]

Therefore, if a resident in one country earns source income in another country, double taxation is likely to occur because the source country is going to tax that income on a source basis and the other is going to do it on a residence basis.[13] In this case, the international accepted principle is that the source country has the right to tax and the residence country is obliged to relieve double taxation.[14]

There are several rules to achieve the elimination of double taxation through tax conventions. As a general one, an exclusive right of taxation is conferred to the State of residence with respect to several items, being the other State prevented from taxing those items.[15] However, pursuant to other type of income[16], the right to tax is not an exclusive one and both States may tax but in some cases the amount of tax that the source State may impose is limited to certain threshold.

In terms of the foregoing, as long as some provisions confer the State of source a right to tax, the State of residence is obliged to grant relief to avoid double taxation derived from the residence country's taxation of income originated outside its territory.

2.2. METHODS FOR THE AVOIDANCE OF DOUBLE TAXATION

Tax treaties essentially provide, respectively in their Articles 23 A and 23 B for two basic methods for the avoidance of juridical double taxation: the exemption method and the credit method.

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[12] Victor Thuronyi, *Tax Law Design and Drafting* (Washington, D.C., International Monetary Fund, 1998), p. 721.

[13] In the case of source taxation a nexus is established between the country and the activities that generated the income. Rohit Ganguli, "Triangular Cases – Problems and Solutions", *ASSOCHAM International Tax Conference* (April 2003), 57-63, at 57.

[14] It is relevant to mention that tax treaties Tax treaties only deal with tax liability arising in residence and source forms of overlapping, without dealing with cases involving residence and residence double taxation nor with source and source cases of double taxation.

[15] Under this scenario, the residence country must eliminate double taxation for being such taxation a result of the residence's country taxation of income derived outside its territory.

[16] Income from immovable property located in the State of source or situs may be taxed without restriction in such State and as well profits from a permanent establishment situated in that State and some other items such as dividends and interest may be subjected to limited taxation in that State of source.

The exemption method refers to income that is taxable in the State of source and it is exempted from taxation in the State of residence. However, this income may be taken into account in order to determine the rate of tax applicable to the taxpayer's remaining income.[17]

On the other hand, the credit method refers to income that is taxable in the State of source or situs and is subject also to tax in the State of residence, but the tax levied in the State of source or situs is credited against the tax levied by the State of residence on such income.

Each State may choose the type of relief it wants to grant to its own residents, same approach which depends on the policies adopted either to promote equality in the residence country or equality in the source country.[18]

For purposes of the present paper it is important to differentiate between the granting of a tax exemption and a tax credit, since as it will be analyzed in the next chapters, a certain number of distinct effects may be created upon such difference of election with respect to the application of tax treaties basically in typical triangular situations.

CHAPTER 3

Description of Triangular Situations

3.1. General overview

As previously referred, international tax overlapping has been classically treated under a bilateral modality and accordingly the States involved limit their tax jurisdiction on a bilateral basis in accordance with the tax treaties concluded.[19]

Therefore, under an ordinary pattern, a resident State will eliminate double taxation by any of the aforementioned methods with respect to the source country taxation. As well, it shall occur the same when a resident in one State carries on business through a permanent establishment in the other Contracting State, situation in which the residence State will eliminate double taxation with respect to the

[17] This case is regularly known in the tax practice as *"exemption with progression"*.

[18] With respect to the equality in the residence country, a comparison is made with companies that operate only in the home country in which neutrality *("capital export neutrality")* is viewed from the perspective of the residence country of the investor and the same tax burden should apply to companies investing at home and companies investing abroad. A foreign tax credit is applied and the residence country subjects the foreign income to its own taxation and allows the tax imposed in the foreign country on the foreign income to be credited against its own tax. Regarding the approach of equality in the country of source, it refers to equality in the foreign country in which neutrality *("capital import neutrality")* is viewed from the stand point of the country where the investment is made and an identical tax burden exists between investment by resident investors and nonresident investors.

[19] See García Prats, *Intertax*, supra note 10, at 473.

tax levied by the source State on the income attributed to the activities performed by the permanent establishment.

However, several forms of extraordinary patterns on the application of tax treaties may arise in certain specific situations. An example of extraordinary pattern of application of a tax treaty may arise when a person who is a resident in one state carries on business through a permanent establishment in another state while income from a third State is attributable to such permanent establishment.

The cases like the one described in the preceding paragraph give rise to what in theory and recently in practice has been referred as *"triangular situations"*, cases in which it is not just important that more than two States overlap their tax claims over the same type of income and on the same taxpayer, but in which it is also necessary that the alleviation of more than two taxes on the same income derived from the same taxpayer at an international level takes place. It is worthy to mention that the great majority of triangular situations arise from the fact that a taxpayer has presence in more than one country for tax purposes at the same time and an income is attributable to such taxpayer in one way or another.

As a consequence, a triangular case has been defined as the situation in which a multilateral tax claim leads to a triple taxation[20] on the same subject and income and when the tax relief has to be defined in accordance with the specific facts and circumstances of the case.[21]

3.2. TYPICAL TRIANGULAR CASES

Due to the importance and every time more frequent incidence of cases in which more than two States are involved in a certain transaction and also due to the more involvement of this kind of triangular cases in the day-to-day activities of taxpayers, tax authorities and practitioners as well, the OECD decided in 1992 to study in depth the issue of the interaction among treaties in its 1992 "Triangular Cases" Report, hereinafter referred as the Triangular Cases Report.[22]

In accordance with the analysis effected by the OECD in terms of the Triangular Cases Report, a typical triangular case[23] was described pursuant to the following scenario:

[20] Such triple taxation will occur in the so-called State of source, in the State of location of the permanent establishment and in the State of residence, as it will be further analyzed in the present paper.

[21] See García Prats, *Intertax*, supra note 10, at 475.

[22] OECD. *Triangular Cases, Model Tax Convention: Four Related Studies* (Paris: OECD, 1992). In the present paper some of the issues considered by the OECD in the Triangular Cases Report will be briefly commented and analyzed for purposes of a better understanding of the subject and also as motivation for the last chapter of this paper related to the personal point of view of the author with respect to such triangular cases.

[23] The Triangular Cases Report expressly refers to this kind of ordinary situations as *"typical triangular cases"* and this term has been more recently used by scholars in the analysis of such cases. The opposite term *"atypical triangular situations"* is used in this paper to make reference to extraordinary triangular situations.

- Income from dividends, interest or royalties is derived from a source in State S,
- such income is received by a permanent establishment located in State PE, and
- such permanent establishment depends upon a company resident in State R.[24]

The OECD refers in such study to the most important effects derived from these triangular situations, providing as well the possible different scenarios, the practice of the OECD Member States, the possible solutions and finally the proposal of some changes to the Commentaries to the OECD Model Convention (hereinafter referred to as the Commentary) which have already been incorporated.

Once a typical triangular case has been briefly described, in the next sub-chapter below some atypical cases will be described and in the subsequent chapter the consequences of such cases will be duly analyzed.

3.3. ATYPICAL TRIANGULAR CASES

Although it is not expressly mentioned in the Triangular Cases Report, the complexity of transactions has given rise to another sort of triangular transactions that has broadened the definition of the typical cases of interaction of tax treaties. [25]

In order to make reference to some atypical triangular cases, resort has to be made to case law and doctrine recently developed by scholars. Herein a description shall be made of some of the situations in which a triangular case may arise.

It is important to mention that the cases described below may have several variations and the description is only intended to demonstrate that a triangular case may arise. As well it is relevant to remark that the list of cases to be described is not exhaustive and this study pretends only to be an additional perspective of triangular situations, namely the day to day practice and also a bit of imagination may give rise to new situations which may become triangular situations that hopefully will be analyzed in future studies.

3.3.1. Dual residents

The most common atypical triangular case takes place when the payor or the recipient of income is a dual resident. This case arises when two States treat a taxpayer as a resident [26] and it generally arises when a taxpayer company is incorporated in one State and has its effective management in another State. This

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[24] For a better understanding a diagram is enclosed as **annex 1** to this paper.

[25] And as well some cases posed by some scholars has extended such list of triangular situations to cases which may take place some day in real practice.

[26] Article 4(1) of the Model Convention establishes in its first sentence that *"for purposes of such Convention"*, the term *"resident of a Contracting State"*, is deemed to be any person liable to tax under the laws of that State due to various connecting criteria. The same provision states in its second sentence that the term *"resident of a Contracting State"* does not include a person liable to tax in that State only regarding income from sources in that State or capital situated therein, same legal provision that will be discussed further in detail below in this paper.

problem is solved between the countries by applying the so-called "tiebreaker rule"[27] in order to determine which of the two countries will be considered as the residence country (Winner State) and which not (Looser State).[28]

The corresponding treaty between these Winner and Loser States deals exclusively with the relationship between those two States but has no relationship between either of those states and a third State and therefore the taxpayer will remain as resident of both states in connexion with treaties with third states, being applicable the treaties between both Winner and Loser and third States.[29]

3.3.2. Income from employment

In terms of Article 15(1) of the Model Convention, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State.

However, the second paragraph of the same provision establishes that remuneration derived from an employment exercised in a Contracting State by a resident of another Contracting State, shall be taxable only in the State of residence of the employee if (i) the recipient is present in the other State for a period not exceeding in the aggregate 183 days on any twelve month period commencing or ending in the fiscal year concerned, or (ii) if the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, or (iii) if the remuneration is not borne by a permanent establishment which the employer has in the other State.

In terms of this provision, a triangular situation with no problematic solution will arise even if a resident of a Contracting State is employed by an employer which is resident in another State and the services of the employee are performed in a third State. In this case, as long as extraordinary circumstances do not take place, the State in which the activity is exercised will have the right to tax to the extent that none of the conditions of the preceding paragraph are met.

However, the doctrine has developed another type of triangular situation with respect to employment income, same situation which arises when an employer resident in one State (State A) hires an employee resident in another State (State B) who performs his services in a fictitious permanent establishment (in accordance with the offshore provision of Dutch tax treaties and not in accordance with the general

[27] The *"tie breaker rule"* purviewed in Article 4(3) of the Model Convention states that where a person distinct to an individual is deemed to be resident of both Contracting States, it shall be considered to be a resident only of that State in which its place of effective management is situated.

[28] For a better understanding please refer to the diagram exhibited as **annex 1** to this paper.

[29] John Avery Jones and Catherine Bobbett, "Triangular Treaty Problems: A Summary of the Discussion in Seminar E at the IFA Congress in London", *IBFD Bulletin* (January, 1999), 16-20, at 16. This situation can be confirmed in terms of the definition of a *"resident of a Contracting State"* set forth in Article 4(1) that expressly establishes such definition *"For the Purpose of this Convention..."*, being thus applicable such definition exclusively to the parties of a certain Convention and not to third parties.

concept of permanent establishment set forth in Article 5 of the Model Convention)[30] located in State PE that bears the remuneration of the employee.[31]

With respect to income from employment, the offshore provision in Dutch tax treaties is a distributive rule with derogative effects that has been drafted in three different types of provisions. First, setting forth the taxing right to the source State whether an employment relationship with respect to the offshore activities through a permanent establishment in the PE State exists and the employment is exercised offshore in the other State. Second, equal to the first type but does not require that the work is performed through the permanent establishment. Third, that requires an employment to be performed for more than 30 days in a 12-month period.[32]

Under the above referred scenario, it must be assumed that the States have concluded treaties following the Model Convention and specifically with respect to States A and PE it must be assumed that they have concluded a treaty which contains an offshore provision.

3.3.3. Profits from international transportation

In terms of Article 8 of the Model Convention, profits from the operation of ships or aircrafts in international traffic shall be taxable only in the Contracting State in which the place of effective management of the corresponding enterprise is situated.[33]

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[30] Hans Pijl, "The Fictitious Permanent Establishment Offshore in Dutch Domestic and Treaty Law", English translation of the article in Dutch published in *Weekblad voor Fiscaal Recht* 2002/6500, at 13 ff. In terms of this article, it is relevant to mention that the author refers to the fictitious permanent establishment not as an ordinary permanent establishment in terms of Article 5 of the Model Convention but as a *"fictitious offshore permanent establishment"* deemed to exist under the oil and gas business for exploration and exploitation activities carried on outside the moles (e.g. piers) in territorial waters or on the continental shelf of the Netherlands for 30 days or more in accordance with the modifications to the Dutch domestic law on the Act of 13 December 1989 currently existing in Article 7(4) of the Individual Income Tax Act 2001 and Article 17a, Preamble and Part f of the Corporate Income Tax Act of 1969. This legal provision has been generally referred to as the "offshore provision" and, if included in Dutch tax treaties, a fictitious permanent establishment exists whether offshore (meaning outside the port) activities involving exploration or exploitation of the seabed and subsoil are performed for more than 30 days in a period of 12 months or in a calendar year.

[31] Please refer to the diagram enclosed as **annex 2** of this paper.

[32] See Pijl, *supra* note 30, at 15. In this regard, the author makes a reference to the Netherlands-United Kingdom treaty with respect to the second type of offshore provision for employment and to the Netherlands-Norway treaty with respect to the third type of offshore provision for employment. He also refers to the Netherlands commentaries to treaties in which it is set forth that income from employment by an authentic Article 5 permanent establishment or a fictitious permanent establishment is always subject to taxation in the State in which the employment is effectively exercised, following thus the general rule for income from employment provided in Article 15 as long as this income is borne by the permanent establishment. Accordingly, the author upholds that what is set forth in the Dutch commentaries corroborates the derogative nature of the offshore provision for employment being applied as standard method for the avoidance of double taxation the "exemption plus method" which requires to exist proof of tax payment in the State where the activities are performed.

[33] This situation with respect to international transportation has been generally referred as the principle of *"reciprocal exemption"* by which the exclusive jurisdiction to tax is conferred to the State in which the enterprise engaged in international transportation is either effectively managed or resident.

Scholars have prepared cases in which a triangular situation may arise with respect to the application of Article 8 of the Model Convention. A suitable example may be the case[34] of a company resident of a Contracting State A which has its place of management in Contracting State B and which provides services of international transportation[35] between the following points:

1) Within the State of residence A.
2) Between the State of residence A and the State of effective management B (existing a treaty under the Model Convention between these two countries).
3) Within the State of effective management B.
4) Between the State of residence A and a third State C (existing a treaty under the US Model between these two countries).
5) Between the State of effective management B and the same third State C.
6) Within a fourth State D.
7) Between the third State C and fourth State D.
8) Within the fourth State D.
9) Between the State of residence A and the fourth State D (existing treaty between these countries without Article 8). State A is deemed to have a permanent establishment in this country.
10) Between the State of effective management B and the fourth State D.[36]

In terms of the foregoing and in accordance with the Model Convention, the State of effective management of an enterprise has the right to tax the profits derived from the operation of a ship or aircraft in the international traffic to the extent that such international transportation does not take place solely in the State of residence, situation in which this latter State will have the right to tax. With respect to the US Model Convention, the State of residence will have the right to tax the profits derived from the international transportation except in the case the transportation takes place in one of the Contracting States.

Gian Marco Sarno, "Shipping, inland waterways and air transport under Article 8 OECD Model Convention", *LLM Paper for the LLM Program in International Taxation*, (Leiden, 1999-2000), p. 1.

[34] These facts have been taken from a case prepared by Hans Pijl for a lecture at the LLM in International Taxation at Leiden University, Leiden Institute for International & Comparative Tax Law, Leiden, The Netherlands, 1999. However, some modifications have been added with the main purpose to exemplify a triangular situation arising under the sole application of Article 8 of the Model Convention.

[35] In accordance with Article 3(1) e) of the Model Convention, *"international traffic"* is regarded to be any transport by ship or aircraft operated by an enterprise that has its effective place of management in a Contracting State, except when such ship or aircraft is operated solely between places in the other Contracting State. On the other hand, for purposes of the current paper, in terms of the September 20, 1996 United States Model Convention (hereinafter referred to as the US Model Convention), *"international traffic"* is regarded as any transport by ship or aircraft, except when such transport is solely between places in a Contracting State.

[36] For a better understanding, this example is illustrated with the diagram contained in **annex 2** to this paper.

3.3.4. Income derived by artistes and sportsmen

The first Paragraph of Article 17 of the Model Convention, states that income derived by a resident of a Contracting State as an entertainer or as a sportsman, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State.

The second paragraph of such provision sets forth that when the income regarding personal activities exercised by an entertainer or a sportsman in his capacity as such accrues not to the entertainer or the sportsman himself but to another person, that income may be taxed, notwithstanding the provisions of Articles 7 and 15, in the Contracting State in which the activities of the entertainer or sportsman are exercised.

In terms of the foregoing, a primary right to tax is given to the State of performance even if the income is accrued by some other person, provision that may be construed as a look through provision on the person accruing the income and as consequence the performer will be directly taxed.

Under this specific provision, a triangular situation may arise when the legal entity accruing the income is neither resident of the State where the performance has taken place or where the artiste or sportsman is resident, arising the question of which treaty should be applied, situation that will be discussed in detail below in this paper.[37]

CHAPTER 4

Problems arising from typical triangular cases

The problems arising in a typical triangular situation have already been analyzed in the Triangular Cases Report . Such report makes a difference on the fact that the State of residence either applies tax exemption or tax credit as methods for the avoidance of double taxation.

For purposes of the analysis covered by the Triangular Cases Report, it is assumed that each of the countries involved has concluded a treaty in accordance with the content of the Model Convention. Following a brief analysis is made on the main issues pointed out in the Triangular Cases Report for a better understanding of the subsequent chapters of the paper.

4.1. State of Residence applying the credit method

As previously mentioned, a typical triangular situation arises when income from dividends, interest or royalties is derived from a source in State S, such income is received by a permanent establishment located in State PE, and such permanent establishment depends on a company resident in State R.

[37] For a better understanding please refer to the diagram exhibited as **annex 3** to this paper.

In order to analyze the different consequences arising in each of the countries involved, three separate scenarios may be analyzed: (i) the relationship between State S and State R, (ii) the relationship between State R and State PE and finally (iii) the relationship between State S and State PE.

This approach on the differentiation of the legal relationships arising in a typical triangular situation among the States involved is done with the purpose of simplification for a better understanding and also taking into account the possibility to consider the legal status of one State in front of the other with respect to the rights and obligations derived from the applicable facts and circumstances.

i) *Relationship between State S and State R*

Under this scenario, State S will impose a limited withholding tax in accordance with its treaty with State R for being a payment to a resident in this latter State although such a payment is attributed to a permanent establishment situated in State PE.[38]

On the other hand, State R will tax the income derived from State S by its resident on a worldwide basis taxation. Since the payment will be effected to a resident, although attributable to a permanent establishment, State R would be in principle obliged to grant relief for double taxation through the granting of a tax credit for the tax withheld in State S.

ii) *Relationship between State R and State PE*

State R will tax the income attributable to the permanent establishment of its resident and then grant a tax credit up to its own taxation for the passive income received by the permanent establishment. State R will be also in principle obliged to grant a credit for the tax withheld in State S as mentioned above.

State PE will tax the income attributable to the permanent establishment located therein, including the income derived from State S.

iii) *Relationship between State S and State PE*

There will be no applicable treaty between these two States because the permanent establishment is not regarded as a resident of State PE.

4.2. STATE R APPLYING TAX EXEMPTION

One more time we will refer to the separate relationships that may arise in a typical triangular situation, mainly those between (i) State S and State R, (ii) State R and State PE and (iii) State S and State PE.

i) *Relationship between State S and State R*

State S will still apply a limited withholding tax for being a passive income derived from one resident in State S and received by a resident in State R. This is the applicable situation although the income will be

[38] Accordingly, the resident in State R is deemed to be a person resident in one Contracting State and therefore is entitled to the benefits of the corresponding treaty.

attributable to a permanent establishment that a resident in State R has in State PE. Such income will be exempted in State R for being applied the income exemption in this country and no tax credit will be granted for the tax withheld in State S.

ii) *Relationship between State R and State PE*

State R will exempt the income attributable to the permanent establishment and State PE will tax such income.

iii) *Relationship between State S and State PE*

No treaty will be applicable between these two States because the permanent establishment is not a resident in State PE.

4.3. ISSUES NOT YET CLEARLY SOLVED

There are some issues that although already referred in the Triangular Cases Report, they are still pending to be clearly solved, such as the ones referred hereinafter.

As it can be observed from the above described scenarios, when State R grants a tax credit for the avoidance of double taxation, such tax credit will be limited to the taxable amount in State R. Therefore, if the tax amount to be taxed in State R does not exceed the taxation of State PE with respect to the attributable profits to the permanent establishment, State R will be impeded to grant a tax credit for the tax imposed in State S, arising thus double taxation.

Furthermore, State R is not able to eliminate double taxation when it exempts the income attributable to the permanent establishment and that is taxed in State PE, same income also will be taxed in State S.

The problems referred in the two preceding paragraphs resort to the possibility that the State PE grants relief for the taxation of State S, either through the application of the non-discrimination clause or though the freedom of establishment with respect to the European Union. Another possible solution to be discussed further in this paper is to grant the permanent establishment the treatment of a resident in State PE to the extent that a triangular situation arises and it such triangular situation is expressly recognized in a concrete case.

As well, some other problems arise in the above described scenarios, as it is the case of tax avoidance and treaty shopping, same situations that will analyzed herein below.

4.3.1. Non discrimination clause

The first sentence of Article 24(3) of the Model Convention lays down the “permanent establishment non-discrimination provision”,[39] setting forth that taxation of permanent establishments of enterprises of a

[39] John F. Avery Jones *et al.*, “The Non-Discrimination Article in Tax Treaties-II”, 11 & 12 *British Tax Review* (1991), 421-452, at 421.

Contracting State shall not be less favorably levied in comparison with enterprises carried on by a resident of the other State carrying on the same activities.

The extent to determine whether discrimination arises depends on the comparison of the activities performed by a domestic enterprise located in a contracting State in which the permanent establishment is situated and both, the enterprise and the permanent establishment, should be engaged in the same type of activities.[40]

Scholars have examined some cases in which the permanent establishment non-discrimination clause is analyzed. One of these cases[41] arises in a triangular situation in which a company resident in State S pays interest income to a company resident in State R and such income is attributable to a permanent establishment in State PE of such company resident in State R. States R and PE have concluded a treaty with the permanent establishment non-discrimination provision. There is no treaty between the States R and S and there is a treaty between States PE and S which provided for a reduction to 10% of the 25% tax rate applicable in State S to interest payments.[42]

The application of the permanent establishment non-discrimination provision of the R-PE States treaty in this case leads, in accordance with the author,[43] to establish that State PE is obliged to treat the permanent establishment carrying out an enterprise within its jurisdiction as if it were an enterprise of one of its own resident taxpayers.

On the other hand, under the PE-S States treaty, a resident of State PE who receives interest income from State S is entitled to a reduction in the withholding tax to be applied by State S to a 10% (instead of the 25% that State S would apply) and also to a credit up to that 10% withholding tax.

However, the following circumstances should be taken into account when considering the application of the aforementioned permanent establishment non-discrimination provision:

a) Bearing in mind the relative effect of treaties which are applicable only to resident persons in terms of Article 1 of the Model Convention, State PE cannot extend the category of persons entitled to invoke the treaty with State S to include residents of another State as it would be the case of the resident of State R. Therefore, no reduction of tax will apply with respect to State S tax withholding, being entitled this latter State to make an ordinary withholding of 25% rather than the pretended 10% withholding.

[40] A critic can be done to the permanent establishment non-discrimination provision in the sense that it extends the scope of application of tax treaties which, as above explained, are bilateral by nature and extends relief rules of residents to non-residents, as it is the case of permanent establishments.

[41] Kees van Raad, “Issues in the Application of Tax Treaty Non-Discrimination Clauses”, *IBFD Bulletin* (August/September, 1988), 347-351, at 348.

[42] Please refer to the **annex 3** of this paper for a better understanding.

[43] See van Raad, *supra* note 41, at 348.

In this regard, it has to be underscored that the obligation acquired by State PE to treat permanent establishments as enterprises carried on by a resident was assumed with respect to State R. Such obligation cannot by principle of law be extended to State S with respect to the reduction of withholding rate and therefore State PE cannot in anyway extend the category of person to the permanent establishment carrying on an enterprise in its territory with the above referred effects.

b) Furthermore, pursuant to the credit that State PE must grant with regard to the tax withheld by State S to the permanent establishment's income under the R-PE States treaty, State PE shall have to grant the same tax credit as granted to its own residents under the PE-S States treaty[44]. Such credit[45] will arise to a maximum amount of 10% (instead of the already withheld 25%) since the residents of State PE would be taxed at a 10% rate under the PE-S treaty.

   This situation would bring for PE State to grant an additional tax credit of 15% under its unilateral tax relief provisions due to its obligation to treat a permanent establishment of foreign companies as its own resident.[46]

In terms of the foregoing, it can be observed that the application of the permanent establishment non-discrimination provision, in accordance with the opinion of the cited author, creates certain problems in practice that still have to be dealt in practice by taxpayers, tax authorities, of course by tax advisers, and why not by tax courts in the near future.

In fact, the permanent establishment non-discrimination provision is still creating controversy with regard to the extent that permanent establishments can invoke or can rely on the benefits of its scope to alleviate double taxation.

Some countries have denied the application of the non-discrimination clause arguing for this purpose that such a clause may be overridden by internal legislation,[47] but some other States agree with its content

[44] Paragraph 49 of the Commentary to Article 24 of the Model Convention states that when a permanent establishment receives foreign income, a tax credit should be granted under the permanent establishment non-discrimination clause as such credit would be granted to resident enterprises under domestic laws. In this regard, it has been questioned by various scholars if such relief should be deemed to be extended also to the double tax conventions. See Martín Jiménez, *supra* note 5, at 245.

[45] The same paragraph 49 of the Commentary to Article 24 of the Model Convention refers exclusively to tax credit as the type of double taxation relief to be extended, without existing any ground for such restriction. Therefore it should be extended also to exemption in the PE State. Kees van Raad, "The 1992 OECD Model Treaty: Triangular Cases", *IBFD European Taxation* (September 1993), 298-301, at 299.

[46] Such credit is not granted by some States (such as Ireland and United Kingdom which only grant it in limited cases) and even some others do not grant is to its own residents. See Avery Jones, supra note 29, at 17. However, in accordance with paragraph 52 to the Commentary to Article 24 of the Model Convention, a majority of the OECD member States indeed give such relief to permanent establishments.

[47] This interpretation is not allowed by Article 27 of the Vienna Convention, which forbids to one party of an international treaty to invoke provisions of its internal law as a justification for its failure to perform the obligations acquired under a treaty.

even that sometimes are not perfectly aware of the scope of the legal provisions integrating Article 24 of the Model Convention.

4.3.2. Freedom of establishment

Article 12 of the European Community treaty[48], hereinafter referred to as EC Treaty, contains a general prohibition on discrimination based on nationality within the scope of the same treaty and such prohibition is applicable to the extent that no other provisions of the treaty deal with specific prohibitions of discriminations.[49]

On the other hand, Articles 39 to 48 encompass the freedom of movement of persons. Such freedom includes both the freedom of employees to apply and accept jobs in other Member States and the right of undertakings, including self-employed professions and to setting up and opening branches, subsidiaries and agencies in other Member States. With respect to employees, the freedom is known as free movement of workers and the right of undertakings and self-employed persons is known as the right of establishment.

The right of establishment is relevant for the purposes of this paper since it includes the right to set up and manage undertakings (as market access) and the right to equal treatment (as market equity). The right to set up a new undertaking is known as a primary establishment and the right to set up branches, agencies or subsidiaries of existing undertakings is known as secondary establishment.

The right of establishment is conferred upon individuals having the nationality of one of the Member States and upon companies or firms having registered office, central administration or place of business within one of the Member States.

In terms of the foregoing, the right of establishment envisaged by the EC Treaty requires a Member State in which a permanent establishment is set up to treat such permanent establishment as a resident of such State. This means that such State must apply its domestic law with respect to the permanent establishment without restriction and must provide for relief for the tax withheld in the State of source to the permanent establishment of a company resident in the European Union provided it does so for its own residents.

Article 24(3) of the Model Convention provides that the Contracting State in which a permanent establishment is located not to tax such permanent establishment less favorably than its own enterprises, namely requiring the PE State to apply its domestic law (and in the opinion of some authors also the

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[48] This treaty was concluded in Rome on March 25, 1957, establishing the European Community. It was amended by the Treaty on the European Union concluded in Maastricht, on February 7, 1992. Such treaty was further amended by the Treaty on the European Union concluded in Amsterdam on October 2nd, 1997 and entered into force on May 1st, 1999.

[49] Specific prohibitions of discrimination are specifically dealt within the EC Treaty. In this regard, the EC market is characterized by the abolition among the Member States of all obstacles to free movement of goods, persons, services and capital. These four freedoms encompass the principles of a right to cross-border circulation (known as a market access) and a prohibition of discrimination on grounds of nationality (known as market equality). Ben J.M. Terra and Peter J. Wattel, *European Tax Law*, (Deventer: Fiscale Studieserie, 2001), p. 30.

treaty rules) to non European Union companies with permanent establishments therein. On the other hand, the freedom of establishment is part of EC law, therefore Article 24(3) of the Model Convention extends the treatment prescribed by the freedom of establishment to companies resident outside the EU with a permanent establishment in the EU and others have argued that this amounts to a most-favored nation treatment which goes beyond what is provided by Article 24(3) of the Model Convention.[50]

It has also been established that in accordance with a prevailing position, under the non-discrimination clause contained in Article 24(3) of the Model Convention, the permanent establishment State is obliged to grant the credits under its domestic laws in order to prevent double taxation but not treaty relief included in treaties with third States.[51]

4.3.2.1. The *Saint-Gobain* Case

On 21 September 1999, the European Court of Justice (hereinafter referred to as ECJ) handed down its decision on the *Saint-Gobain* case.[52] This case is considered to be a landmark case for being a decision dealing with the application of Community law on the application of tax treaties in a triangular situation.

Under the facts of this case, a German branch (permanent establishment) of a French company held shares in companies in some European Union member States and in third States and such permanent establishment received dividends from such shares.

In accordance with German Law, a participation exemption and a tax credit for underlying dividends were granted only to residents (and not to permanent establishments) either unilaterally or by tax treaty, arguing the tax authorities that the branches and the subsidiaries were not in the same footing since a tax withholding may be levied on companies upon redistribution on dividends, situation that could not be comparable with permanent establishments in which only an internal transfer of dividends would take place

The Court upheld that the refusal to grant participation exemption to the permanent establishment made less attractive to have intercorporate holdings through branches in comparison with resident companies, restricting thus the freedom to choose the most appropriate legal form as secondary establishment.

Therefore, German branches and resident companies were in identical situation (in both cases the dividend is subject to German taxable base, the branch partially regarding branch profits and residents under unlimited tax liability) and in terms of the national treatment principle member states should grant to permanent establishments the advantages provided by the treaty on the same conditions as those applied to residents

[50] See Avery Jones, *supra* note 39, at .18.

[51] See Martín Jiménez, supra note 5, at 245. Klaus Vogel also states that *"Article 24(3) does not require the State of the permanent establishment to apply the rules of a double tax convention with a third State to permanent establishments of the other Contracting State".* Klaus Vogel, *Klaus Vogel on Double Taxation Conventions* (London: Kluwer Law International, 1999), at 1320.

[52] *Compagnie de Saint-Gobain SA, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt*, case 307/97 of 21 September 1999.

The decision of the ECJ is based upon the freedom of establishment, implying that a company based in one Member State and having a permanent establishment in another Member State is entitled with regard to such permanent establishment to receive the same treatment as the treatment granted to resident taxpayers.[53]

Several aspects might be commented from this decision of the European Court of Justice. However, for purposes of this paper it is only relevant that the Court has already expressed its position in this regard, stating the validity of the freedom of establishment with respect to EC tax law.

4.3.3. Tax avoidance

An issue has been raised in the OECD Triangular Report with respect to tax avoidance in the case where income arising in State S and paid to a permanent establishment in a tax haven is taxed very little or even not taxed.

Under the traditional approach of applying the permanent establishment non-discrimination provision of States R and S treaty, the OECD stands that the creation of a permanent establishment in a tax haven may be avoided through the inclusion in the treaty between R and S a provision in which the advantages of the treaty will be granted to permanent establishment in third countries to the extent that the permanent establishments pay ordinary tax in the country in which they are created. This situation of tax avoidance has already been covered in the Commentary to Article 24 of the Model Convention.[54]

Another case of tax avoidance already covered in the Commentary to Article 24 of the Model Convention is the situation in which a Contracting State of which the enterprise is a resident exempts from tax the profits of the permanent establishment, where there is a risk that the enterprise will transfer assets to permanent establishments which are subject to favorable tax treatment and under certain circumstances the income may not be taxed.

As well, the OECD Triangular Report states that this advantage to be taken by the resident in State R with respect to the favorable treatment of a permanent establishment can be avoided through the application of Article 7 of the Model Convention in which State R may argue that the income is in fact not attributable to the permanent establishment and tax the income from State S and refuse the tax relief with respect to the claim of the permanent establishment.

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[53] A moderate interpretation has been given to this decision, in the sense that it only prescribes a mandatory application of the recommendations set out in the OECD Commentary on Article 24(3) of the Model Convention. Another point of view is a revolutionary interpretation of this decision in the sense that the freedom of establishment represents the treatment of a permanent establishment as a resident of the State of the permanent establishment under the tax treaty concluded between the source State and the State in which the permanent establishment is located. H.E. Kostense, The *Saint-Gobain* case and the application of tax treaties. Evolution or revolution?, EC Tax Review (2000/4), 220-232, at 228.

[54] This provision has been added in 1992 as part to paragraph 53 of the Commentary to Article 24.3 of the Model Convention.

4.3.4. Treaty shopping

As long as only residents are entitled to the benefits of tax treaties, non-resident taxpayers have frequently sought to obtain the benefits of a tax treaty by organizing a corporation or other legal entity or even creating a permanent establishment to serve as a conduit of income earned in certain State and therefore obtain the benefits of the treaty network of such State.[55]

With respect to treaty shopping[56], the Triangular Cases Report anticipates a danger of treaty shopping when State R eliminates double taxation of the permanent establishment's profits by means of the exemption method. This means that enterprises of State R would, in the absence of a treaty between State R and State S, after setting a permanent establishment in State PE, take advantage of the treaty between States PE and S.

It also could occur that residents in State R could set up permanent establishments in different jurisdictions to take advantage of the more beneficial withholding rates under the treaties in which the permanent establishments were located in comparison to the withholding rates applicable to the State of residence. By means of setting up a permanent establishment in a certain country, advantage could be taken of its treaty network, even if the State of residence does not have treaties with the countries from which the permanent establishment derives income.

The treaty shopping problem has been a result over the years of the international practice and as consequence of that the permanent establishments are often located in tax havens or low tax countries for tax planning purposes. Accordingly, paragraph 53 of the Commentary on Article 24.3 of the Model Convention provides solutions for the tax avoidance and treaty shopping and points out the possibility to include a provision in the treaty between States R and S (same provision which has been previously referred), by means of which an enterprise will be entitled to claim the benefits of the convention as long as the income obtained by the permanent establishment situated in the other State is normally taxed in such State.

Even that quite often it represents a problem in practice to adopt anti-abuse provisions, some other measures could be implemented to avoid treaty shopping, such as the effective performance of business activities by the permanent establishment and the real and no simulated purpose of setting up a permanent establishment.

4.4. SOLUTIONS ALREADY PROPOSED BY THE TRIANGULAR CASES REPORT

When analyzing the solutions to the problems arising from the typical triangular situations, the Triangular Cases Report refers that two possible solutions could be adopted: (i) To apply the PE and S States treaty

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[55] Brian J. Arnold and Michael J. McIntyre, *International Tax Primer* (Cambridge: Kluwer Law, 1995), p. 115.

[56] The term "treaty shopping" has been referred as the use of bilateral tax treaties by a resident of a non-treaty country in order to obtain treaty benefits that otherwise would not be available but through the interposition of an entity into one treaty country. Rajendra Nayak, "How much longer will Treaty Shopping be Allowed?, *ASSOCHAM International Tax Conference* (April 2003), 48-56, at 48.

to the extent that it is expressly provided for the treatment of triangular situations or to (ii) apply the non-discrimination clause of the treaty between States R and PE through the granting to permanent establishments in State PE of residents in State R the same treatment as enterprises resident in such State PE.

In the case that the States PE and S treaty is applied, this would mean that the permanent establishments set up in State PE would be treated as residents with respect to the taxation of the passive income received from State S. The Report points out that the problem of tax credit with respect to the tax withheld by State S would be solved and State S would have to grant the advantages provided for under the treaty concluded with State PE to permanent establishments of third States with which it might have no treaty. The Report also addresses the problem of the danger of treaty shopping that has been referred in the previous sub-chapter.

This solution has been rejected by the majority of the members of the OECD for being distant from the principles of the Model Convention and international current practices, specially those connected with the relative effect of international treaties and their application of such tax treaties only to residents and also for the danger that this could cause with respect to the aforementioned practices of treaty shopping and tax avoidance.

On the other hand, the most accepted solution proposed by the OECD refers to the application of the permanent establishment non-discrimination clause in terms of the treaty between States R and P and the granting by State PE to the permanent establishments of residents of State R the same treatment as granted in State PE to its own residents.

This solution is reached through the application of the permanent establishments non-discrimination provision, so its validity will depend upon the interpretation given to this clause, the extension given to it and of course the development that it is given to it in the bilateral treaties and of course in the future negotiations of tax treaties to be concluded between the residence State of a company and the State in which such company has a permanent establishment.

The permanent establishments will be entitled to a credit in respect to the income from third countries. The amount of such credit would depend upon the credit to which enterprises of State PE would be entitled, providing certain rules for the cases in which the rates under the treaty between States R and S differ from those provided in the treaty between P and S.

Therefore, the majority of the Member States of the OECD accepted the solution referred to the application of the permanent establishment non-discrimination provision on the basis of the application of the tax treaties only to residents and not to permanent establishments and several amendments were proposed to the Commentary to the Model Convention, same amendments that were incorporated in such Commentary in the year 1992.[57]

[57] Several modifications were proposed to the Commentary to the Model Convention and mainly related with the content of this paper are paragraphs 52 to 56 of the Commentary to Article 24(3) of the Model Convention, same paragraphs that are referred and commented along this paper.

CHAPTER 5

Problems arising from atypical triangular situations

5.1. DUAL RESIDENTS

As explained before, a dual residence case will arise when two treaties apply to both receipt and payments and a taxpayer is regarded to be a resident (and in fact subject to full tax liability) of both States under the internal law of such States, being the treaties of both States applicable with respect to third States. For purposes of a better understanding, it has to be differentiated between the dual resident company as recipient of the income or as payor of such income.

5.1.1. Dual resident as recipient of the income

It is clear that both residence States of the recipient of the income will be willing to tax the corresponding income received. This is solved through the application of the tie-breaker rule envisaged by Article 4.3 of the Model Convention, same which establishes that the dual resident will be considered to be resident between these two States in the place in which the effective management is situated.

Furthermore, the source State will be obliged to apply two treaties, one with the Winner State and the other with the Looser State. Two restrictions will arise in the source country of taxation with respect to the income received by the dual resident. In applying such treaties, the source State will satisfy the obligations to withhold under both treaties by making the corresponding tax withholding at the lowest rate of both treaties.

This means that if a treaty between Source-Winner States provides for a withholding tax rate that "should not exceed" from 5% and the treaty between Source-Loser States establishes a withholding tax rate that "should not exceed" from 10%, the Source State will duly comply with its right to tax under both treaties by effecting the withholding at the rate of 5%, since that rate is not exceeding from the percentage allowed under both treaties.

It is remarkable to mention that the situation of dual residence from the perspective of the recipient may lead the taxpayers to take advantage of this effect by becoming dual residents in order to apply a second treaty which may result in a more favorable tax treatment.[58] In this regard, some anti-abuse provisions may be drafted in order to prevent that the dual residence is used for these purposes.

5.1.2. Dual resident as payor of the income.

Again in this case two problems would take place. Both double resident companies will tax the outgoing payment and double taxation will come up. The question that logically arises is whether the State of

[58] This more beneficial situation is not only applicable to rates of withholding but also for some other aspects as it might be the case of a more restricted definition of the duration of a building project considered to be a permanent establishment. See Avery Jones, *supra* note 29, at 19.

residence of the recipient should grant or not dual relief both for the tax levied in the Loser State and the tax imposed in the Winner State.

Although the Model Convention and its Commentary do not specifically deal with this situation, the State of residence should provide for double relief under the obligations assumed in each of the applicable treaties (both with Winner and Loser States) or even under the relief provided under its internal law.

5.1.3. Netherlands Supreme Court's decision on 28 February 2001.

The Netherlands Supreme Court *(Hoge Raad)* decided on a case[59] dealing with taxation of distribution of retained earnings to a Belgian resident individual by a BV incorporated in the Netherlands. The place of effective management of such Dutch BV had been transferred to the Netherlands Antilles and therefore it was regarded as a dual resident.

The question arising from this case is whether the Netherlands still had the right to tax the dividend in this situation. According to the Supreme Court, the Netherlands did not have the right to levy a withholding tax, being prohibited such taxation by Article 4(1) of the 1970 income and capital tax treaty between the Netherlands and Belgium.[60]

In accordance with the first sentence of Article 4(1) of the Model Convention, the term "resident of a contracting State" means any person who under the laws of such State is liable to tax by reason of domicile, residence, place of management or any other criterion of similar nature. The second sentence of such provision establishes that such a term does not include any person who is liable to tax in that State in respect only of income from sources in that State.[61]

In terms of Article 2(4) of the Dutch Corporate Income Tax Act 1969, a company incorporated in accordance with the laws of the Netherlands was deemed to be a resident in such country and subject to income tax on a worldwide basis, arising thus the question whether a Dutch company with effective management in another country could be deemed to be a resident under the tax treaty between the source State and the State of residence.[62]

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[59] Decision in Case No. 35557, Supreme Court *(Hoge Raad)* of 28 February 2001 published in *BNB* 2001/295c.

[60] Stephan Damen, "Netherlands Supreme Court Rules on the Residence of Dual Resident Companies under Tax Treaties with Third Countries", *IBFD Bulletin* (July 2001), 290-292, at 290.

[61] In accordance with the Commentary to Article 4 of the Model Convention, this second sentence refers that such situations takes place with respect to individuals, as it is the case of foreign diplomatic and consular staff subject to limited taxation in the country in which they perform their services, excluding as well in terms of such Commentary to foreign-held companies exempted from tax on their foreign income by privileges to attract conduit companies.

[62] In 1989, the Netherlands State Secretary of Finance issued a decree supporting that pursuant to Article 4(1) and 4(3) of the tax treaty between the Netherlands as State of residence of a company and the State of effective management, the company will be considered to be resident in the State where its place of effective management is located. Under such treaty, Netherlands will be restricted to tax only to the extent that income is derived from sources within the Netherlands and the Dutch company will not be considered as resident in the Netherlands for purposes of the treaty between Netherlands and the source

The Supreme Court upheld that as result of the tie-breaker rule of the Netherlands-Netherlands Antilles treaty the BV was not anymore subject to full tax liability in the Netherlands and therefore it would not be regarded as a resident for purposes of the Netherlands under the Netherlands-Belgium treaty.[63] Since the place of effective management of the BV was in the Netherlands Antilles, such BV was only subject to taxation in the Netherlands only to the extent of the income that is attributable to the Netherlands in terms of the Netherlands Antilles-Netherlands treaty and therefore this was not considered as a full tax liability by the Supreme Court in accordance with Article 4(1) of the Netherlands-Belgium tax treaty.

Although several arguments have been sustained against this resolution, the author adheres to the opinion of Kees van Raad in the sense that the second sentence of Article 4 (1) of a treaty between the State of residence and the State of effective management only applies to those States and no application should be derived for the application of tax treaties with other countries. Therefore, the interpretation adopted by the Supreme Court should be generally regarded as incorrect.[64]

5.1.4. Netherlands Supreme Court's decision on 2 September 1992.

With respect to a dividend paid by a dual resident, it has been argued that Article 10(5) of the Model Convention[65], which prevents taxation of dividends or undistributed profits in a State in which a taxpayer has a permanent establishment to which the profits from which the dividends are paid are attributable, is applicable.[66]

The argument referred that this provision prevents the State of incorporation of a dual resident from taxing the dividend, relying the Court on the Commentary on this provision. In this regard, although the Commentary refers to the non application of a secondary withholding, the Court interpreted this provision as a more general prohibition of extraterritorial taxation. Therefore, in accordance with the construction of

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State. Pim M. Smit, "Treaty Residence of a Company in a Triangular Situation: Decision of the Supreme Court of 28 February 2001", *IBFD European Taxation* (April 2002), 155-158, at 157.

[63] Kees van Raad has sustained that the second sentence of Article 4(1) of the treaty between the State of residence and the State of effective management only applies to those two countries since the text of such provision explicitly refers *"for the purposes of this convention"*. Kees van Raad, "International: Dual Residence", 28 *European Taxation* (August 1988), 241-246, at 241. On the other hand, Klaus Vogel supports that the second sentence does not relate to that State which with respect to a person is restricted to taxing his domestic source income by the corresponding treaty. If it would do so, *"…an unintended circular argument would be created"*. See Klaus Vogel, *supra* note 51, at 234.

[64] For purposes of several arguments posed against this decision see Jan W. J. de Kort, "HR 28 February 2001, nr 35.557: The Supreme Court of the Netherlands Reaches a Questionable Decision in a Triangular Dividend Withholding Tax Case, 29 *Intertax 12* (2001), 402-406.

[65] This Article establishes 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…"*

[66] A decision in this regard has been issued by the Dutch *Hoge Raad* (Case 27 252, BNB 1992/379) on the basis of a treaty provision identical to Article 10(5) of the Model Convention. The same criterion has been utilized in Canada, on the case *Hunter Douglas v. The Queen* (1979) CTC 424, 79 DTC 5340.

the Court, such taxation would take place if the State of incorporation were to tax a dividend paid by the dual resident to a resident of another State.[67]

In the opinion of the author, this Article 10(5) prevents only taxation of dividends in the State in which a taxpayer has a permanent establishment but it is not clear if this provision applies to prevent Loser State in a dual residence case to prevent taxation on dividends, since the taxation of the dividend is not related to profits derived from Loser State.[68]

5.2. INCOME FROM EMPLOYMENT

In accordance with the previously described scenario on the existence of an offshore provision in Dutch tax treaties, in principle the taxing right of State PE for the remuneration received by the employee resident in State B will arise from Article 15(2) c), which provides for the taxation in the State in which the employment is exercised for the case in which the remuneration is borne by a permanent establishment which the employer has in the other State. No reference has to be made to the period for which the employment is exercised nor if the remuneration is paid by or on behalf of an employer who is not resident of the other State.

However, although in terms of the treaty between A and PE States a permanent establishment will exist due to the application of the fictitious permanent establishment provision, in accordance with Article 5 of the treaty concluded by the B and PE States no permanent establishment will exist in State PE for the employer resident in State A.

Accordingly, the remuneration of the employee resident in State B will not be taxable in State PE, giving rise to a problematic triangular situation in which non taxation of the remuneration by the employee resident in State B may take place.[69] This situation would bring as consequence the inapplicability of Article 15(2) c) of the Model Convention.

5.3. PROFITS FROM INTERNATIONAL TRANSPORTATION

In accordance with the previously described case, a resident in State A has its effective management located in State B. For these purposes the treaties in which a resident is involved will apply, namely the ones concluded by State A with State B, with the third State C and the fourth State D and thus disregard the rest of the treaties for not existing a resident involved in terms of Article 1 of the Model Convention, same provision that has already been described above in this paper. Therefore, the following consequences would take place:

a) If the A-B States Model Convention is applied, State B will have the right to tax all the transportation movements in terms of Article 8 of the Model Convention except for the movement

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[67] See Kees van Raad, *supra* note 45, at 301.

[68] Accordingly, it has been suggested that Article 10(5) of the Model Convention should be redrafted in the same terms of the US Model Convention. See Avery Jones, supra note 29, at 20.

[69] See Hans Pijl, *supra* note 30.

1 that takes place within the State A as the State of residence. This movement shall be taxed by State A in accordance with Article 7 of the Model Convention for not being international transportation but business profits.

b) When applying the State A-third State C treaty (concluded under the US Model Convention), State A shall have the right to tax all the transportation movements in terms of Article 8 except for the two movements that take place within both State A and the third State C (movements 1 and 6) that will be taxed in the same State A in accordance with Article 7 of the treaty.

c) When applying the State A-fourth State treaty, State A will be entitled to tax all the transportation movements unless the resident in State A is deemed to have a permanent establishment in one of the other States. In such a case, the fourth State would have the right to tax the profits attributable to the permanent establishment and the State A would have to provide relief for such taxation.

In terms of the foregoing, as conclusion, State B will be entitled to tax nine of the transportation movements and State A shall have the right to tax only one of the transportation movements. The fourth State D shall have the right to tax the profits attributable to the permanent establishment and the third State C will not have the right to tax any profits. State A is obliged to grant relief for the taxation of the permanent establishment in the fourth State D.

As it can be seen, State A gives up its taxation derived from the application of the treaty with the third State, same giving up of taxation that corresponds with the application of the treaty with State B from which it results that State A is only entitled to taxation with respect to one of the transportation movements. Additionally, State A would be obliged as State of residence to provide relief for the tax to be levied in the third State.

This situation of interaction of treaties may bring as consequence a problematic situation for State A as long as it renounces, due to the application of different tax treaties, to tax the profits that in principle it was allowed to tax. This situation is derived from the interaction of treaties arising in the concrete triangular situation and may have a multitude of variations to which a general solution is difficult to be proposed.

5.4. INCOME DERIVED BY ARTISTES AND SPORTSMEN

As it has been described above, a problematic triangular situation may arise with respect to the application of Article 17(2) of the Model Convention when a legal entity accruing the income is not a resident of the State in which the performance has been effected or where the artiste or sportsman is a resident, namely that the performer is resident in a third State. The question is which treaty should be applied in such a case.

Under this situation, it will be relevant that the tax treaty existing between the State of performance and the State of residence of the legal entity receiving the remuneration on behalf of the performer contains a provision in terms of Article 17(2) of the Model Convention.

If domestic law of the State of performance attributes income to the performer even when the payment is done to a third party (by means of a look-through provision), then the treaty of the State of performance

and the treaty of the State of residence of the performer should apply under what it is covered by Article 17(1) of the Model Convention.[70] In this situation, the legal entity receiving the payment would be disregarded and as well the circumstances related to it, since the source State (State in which the performance has taken place) will be allowed to tax the remuneration irrespective of whether Article 17(2) has been incorporated into the relevant treaty.[71]

On the other hand, if domestic law of the State of performance attributes income to the legal entity that is receiving the payment, the issue is whether the presence of Article 17(2) of the Model Convention in the treaty between the State of performance and the State of residence of the legal entity receiving the payment allows the first of these States to tax the remuneration even if the performance has taken place by an artiste or sportsman resident in neither the State of performance nor the State of residence of the legal entity.

In this case, the tax treaty of the State of performance and the treaty of the State of residence of the legal entity should apply, situation that would be controlled by Article 17(2) of the Model Convention.

It is remarkable to note that in 1987 the OECD published a study on the Taxation of Entertainers, Artistes and Sportsmen.[72] In terms of paragraphs 102 to 103 of such study, it seems to be suggested that Article 17(2) is applicable, since it is concluded that the State where the performance takes place may tax the income derived therefrom.

Anyway, some authors have supported that the Commentary should be amended to provide for a clear interpretation on the application of Article 17(2) of the Model Convention to triangular situations.

CHAPTER 6

Some applicable solutions in triangular situations

Although several studies and opinions have been proposed to produce some certainty with respect to the occurrence of triangular situations, some of these studies and opinions have been disregarded and some others have been taken into account in order to create a more defined approach to this type of complicated situations arising in the day to day life transactions.

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70 This situation can be derived from the text of paragraph 8 of the Commentary to Article 17 of the Model Convention.

71 Rijkele Betten and Marco Lombardi, "Article 17(2) of the OECD Model in Triangular Situations. Does Article 17(2) apply if the Artiste or Sportsman is resident in a Third State?, *IBFD Bulletin* (December 1997), 560-654, at 560. It is relevant to mention that in this article a historical development of Article 17 of the Model Convention is effected in order to understand the scope of this provision.

72 *Ibidem*, at 562.

Scholars, practitioners and as well judicial decisions have already analyzed the consequences arising from the occurrence of triangular situations and have tried to prescribe the best steps towards the homogenization of the tax treatment of such situations.

However, due both to the complexity of such triangular situations and to the every time broader and diverse list of this sort of cases, a general solution has not yet been proposed and hardly will be proposed in the future. As well, some of the comments and solutions proposed have been seen as impractical and some others have been disregarded for being considered as unadjusted to the real practices in the negotiation of tax treaties.

In terms of the foregoing, the present paper intends to be an additional perspective on the already several times discussed solution to triangular situations, bearing in mind that a general solution to the problematic issues arising in such cases is impossible until now. Additionally, some other bilateral and not trilateral ideas are presented with respect to possible solutions or at least as the commencement of alternatives to create certainty in taxpayers with respect to triangular situations. Such ideas and alternatives should be analyzed and reviewed under the scope of the currently applicable international tax policies and also under the perspective of the negotiation tendencies of the international tax community.

For purposes of the next subchapters, and as it has been done in terms of the preceding chapters, a differentiation will be made between the typical and atypical triangular cases.

6.1. TYPICAL TRIANGULAR CASES

As it has been previously described, the most accepted solution by the members of the OECD for the problems arising from typical triangular cases has been the development and interpretation of the permanent establishment non-discrimination clause with regard to the tax treaty between the residence State of the company having the permanent establishment and the State in which the permanent establishment is located.

This solution is opposed to the other possibility of considering the application of the treaty between the State of the permanent establishment and the State of source to the extent that such situation is expressly provided for the treatment of triangular situations, same solution that has been generally rejected by the member States of the OECD.

In this regard, the author agrees with the solution already proposed by the OECD as the more practical and the easiest to apply, however, the sole application of the permanent establishment non-discrimination clause of the treaty between the State of residence and the State in which the permanent establishment is located is leading to the application of a treaty that in principle should not be applicable since no legal relationship exists between the taxpayers of such countries

In fact, a resident of State R is performing activities in State PE to which certain legal and tax consequences are attributed due to a legal fiction created for tax purposes. However, no legal relationship exists for being the same person with a different capacity as taxpayer under both jurisdictions (in one jurisdiction as resident and I the other one as a permanent establishment). This approach is opposed to the basic principle of treaties that only apply to residents in terms of Article 1 of the Model Convention.

In a typical triangular situation, the payment of royalties, dividends or interest is being done from a resident of a contracting State to another resident of a contracting State, same payment which is attributable to a permanent establishment located in another State with certain tax and legal consequences.

Therefore, due to the legal fiction[73] of the permanent establishment created only for tax purposes, a fictitious legal relationship arises between the State of source and the State of the permanent establishment. Several rights and obligations for tax purposes are granted to the legal fiction of the permanent establishment, however, in certain respect some other rights and obligations have not yet been granted.

In this regard, a combination of both of the solutions posed by the Triangular Cases Report could be proposed in order to achieve a more complete and sustainable position with respect to typical triangular cases. Thus, the application of the non-discrimination clause or the freedom of establishment for the treatment of permanent establishments as resident companies would still be valid, and additionally, a recognition of the relationship created between the permanent establishment as legal fiction and the State of source.

Such recognition of the legal relationship existing between the State in which the permanent establishment is situated and the State of source would be materialized through the application of the tax treaty between those two countries, situation that has been considered as debatable until now.[74]

This theory would be criticized from the point of view previously described in the present paper that the tax treaties in terms of Article 1 of the Model Convention are only applicable to persons and the permanent establishments are not regarded as persons, however, for purposes of triangular situations a special treatment for the permanent establishments could be provided in the Commentary.[75]

Therefore, the first step to be adopted would be to expressly recognize the existence of triangular situations either in the Commentary or in the Model Convention. Once a triangular situation is deemed to exist, the legal fiction of the permanent establishments should be recognized as a treaty party with the benefits which are granted to the residents of the State PE in which it is established. The consequence would be that the non-discrimination clause with the State of residence would still be applicable (or the freedom of establishment under the EC Law) and the treaty between State PE and State of source would be applicable.

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[73] This legal fiction is deemed to be interrelated with the “personal” tax approach to the taxation of permanent establishments. In this regard, it has been sustained that such personalization of permanent establishments has not been accompanied by extending to the permanent establishments the various measures, either domestic or international, that alleviate or eliminate the multi-taxation of cross-border income. See Martín Jiménez, *supra* note 5, at 241.

[74] *Ibidem*, at 245.

[75] For these purposes, a definition of triangular situations should be included in the Commentary to Article 24(3) of the Model Convention.

Indeed, when a triangular situation would take place, the permanent establishment would be treated as a resident also for purposes of the tax treaty with the source State, with the possibility to grant to the permanent establishment the same conditions as granted to its own residents, and mainly regarding the tax credit granted in terms of the applicable tax treaty.

Accordingly, a high risk of treaty shopping could arise in which residents in certain countries could set up a permanent establishment in a determined State only to take advantage of its treaty network even if the State of residence has no treaties with the countries from which the permanent establishment derives income. In this case, some anti-abuse clauses could be proposed as it is explicitly mentioned in paragraph 53 of Commentary to Article 24(3) of the Model Convention.

As well some other tests could be included as anti-avoidance provisions, such as the permanent establishment effectively carrying on business activities in the State in which it is located, that the income attributed to such permanent establishment is linked to the performance of such commercial activities and some other anti-abuse provisions that have been referred along this paper.

The above referred considerations are only the principle of a position that could be developed taking into account the possible advantages and disadvantages that its implementation could bring. Indeed, this is just a thesis that must be evaluated for further development and that of course could be criticized or even disregarded in future studies.

6.2. ATYPICAL TRIANGULAR CASES

As it can be observed from the analysis carried out in terms of the content of this paper, several different types of atypical triangular cases may arise in practice which may give place to a great diversity of consequences. Accordingly, a general proposal of solution to these cases would result impossible.

The solutions for each of these cases will be proposed on a case by case basis and the countries involved in this kind of transactions will have to review their consequences with basis on their bilateral agreements and their bilateral negotiations. This solutions may as well constitute only the commencement of a procedure to encounter new ideas so as to develop new policies in the recognition, understanding and application of triangular situations.

Following, a brief explanation of the possible solutions for each one of the atypical triangular situations discussed in terms of this paper will be presented.

6.2.1. Dual residents

In terms of this paper the solutions already proposed by some courts have already been analyzed. Such decisions are basically those upheld by the Netherlands Supreme Court on 28 February 2001 and on 2 September 1992.

The solution proposed in the first of these cases deserves to be criticized from the stand point of the author, as it has been previously expressed. As well, the decision adopted in the latter case could be criticized for the adoption of a position under the principle of analogy, since, as it has been referred

before, the provision applied refers to a different legal hypothesis to the one to which it was applied by the Court.

In accordance with the preceding paragraph, the decisions analyzed in this paper with respect to dual residents have not been considered as the most practical and correct solutions, situation that also has been confirmed by some scholars.

In the opinion of the author there is no clear cut solution for the cases of dual residents either as recipients or as payors of the income, same fact that is corroborated in accordance with the provisions of the Model Convention and the content of the Commentary. Therefore, in principle when a dual resident is recipient of the income two treaties shall have to be applied, one with the Winner State and the other with the Loser State, arising two different restrictions as it has been described before.

On the other hand, when the dual resident is payor of the income, the State of residence should provide for double relief with respect to the obligations assumed in terms of each of the applicable treaties.

Both cases could be solved either through bilateral negotiations or through the inclusion of proposals in the Commentary. However, one solution would be to apply only the treaty between the Winner State and the State of source (in the case of dual residents as recipients of the income) or between the Winner State as source State and the State of the recipient of the payment (in the case of a dual resident as payor of the income), restricting thus the application of the treaty with the Loser State in accordance with the tie-breaker rule of these two States. This situation should have to be foreseen either in the Model Convention or in the Commentary exclusively for the case of triangular situations in which a dual resident participates.

Such solution is different to the decision of the Netherlands Supreme Court on 28 February 2001 which was based on Article 4(1) of the Model Convention. This solution would be based on a new proposal to be included in bilateral negotiations or in the Commentary upon the occurrence of a triangular case upon which a restricted application of the Loser State treaty would take place.[76]

This interpretation does not mean that the tie-breaker rule between Loser and Winner States would apply but the consequences of the application of such rule in the case of a dual resident would affect in the specific case of a triangular situation.

6.2.2. Income from employment

As it has been previously analyzed in terms of this paper, this case arising from the application of an offshore provision in Dutch tax treaties is a very specific stipulation that brings as consequence the non taxation in State PE of the remuneration of the employee resident in State B.

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[76] For these purposes, just as it has been stated with respect to typical triangular cases, a definition of a triangular situation should have to be included either in the Commentary or in the Model Convention. Once the existence of a triangular situation is recognized, the above referred proposal of solution could be applied.

Due to the particular circumstances in which this situation may arise, the author believes that also a very special solution should exist in which the Netherlands agrees on a bilateral basis an answer to such problematic application of tax treaties.

One of the possible solutions would be that State PE agrees with its treaty partners through bilateral negotiations to make prevail the offshore provision in Dutch tax treaties over the provisions of other applicable treaties and therefore make it applicable with respect to the right to tax of the country in which the permanent establishment is located, as it would be the case of State PE.

Although this position may be criticized, it represents an approach as intent to solve the problematic application of tax treaties in the case of income from employment where the offshore provision in Dutch tax treaties exists.

The limit to apply this solution would be the existence of a triangular situation for which a definition should be included either in the Model Convention or in the Commentary and once it is recognized the above referred effects could be attributed to the applicable transaction.

Once again it is relevant to mention that the proposed solution should have to be reviewed under the applicable tax policies and negotiation of tax treaties.

6.2.3. Profits from international transportation

As it has been referred before, under the triangular situation described for the application of Article 8 of the Model Convention, the State of residence A gives up its taxation due to the application of several distinct treaties.

Once again this type of atypical triangular case represents a very particular situation and due to its specialty a general solution cannot be proposed.

However, in case that under special circumstances a triangular situation like this one arises in a certain case, the country of residence may negotiate under bilateral agreements with its treaty partners not to renounce to tax the whole income that in principle it could have taxed and it could try to make a reservation for taxation with the State in which the place of effective management is located only in the particular case in which a triangular situation arises.

This type of solution may be seen as unreachable, since for purposes of Article 8 of the Model Convention in which several types of interaction of treaties may take place, a definition of a triangular case would be practically impossible. Additionally, the negotiation of a reserve to tax with the State in which the place of effective management of a company is situated results also almost impossible.

Therefore, in the case of application of Article 8 of the Model Convention to triangular situations although a theoretical solution could be applied, in practice it would be almost impossible.

6.2.4. Income derived by artistes and sportsmen

As it can be noticed form the case described above with respect to income derived by artistes and sportsmen, it seems that the applicability of Article 17(2) of the Model Convention to triangular situations is not yet clear in terms both of the current text of the provision and of the Commentary.

Although an interpretation can be given to such provision depending upon the tax treatment in accordance with the domestic law of the State in which the performance takes place, either the Commentary or the text Model Convention could be amended in order to provide a more certain interpretation of Article 17(2) of the Model Convention and determine if it also applies in triangular situations.

Conclusions

As it can be derived from the present paper, triangular situations arising from the interaction of tax treaties is a topic that although it has been carefully studied with respect to certain specific issues, it still has to be deeply analyzed so as to develop the consequences arising both in the typical and in the atypical situations.

The following conclusions can be derived from the study and analysis carried out for purposes of the present paper:

1.- Tax treaties are agreements concluded on a bilateral basis which are applicable only to the parties involved in the treaty-making process. Such tax treaties only apply to persons and their application cannot be extended to permanent establishments even though the increasing personalization of this legal fiction for tax purposes.

2.- The main purpose of tax treaties is the avoidance or at least alleviation of international juridical double taxation through the exception method or the credit method.

3.- Typical triangular cases arise when payments of dividends, interest and royalties are done to a resident and attributed to a permanent establishment. Several issues come up from these cases with respect to the tax credit to be granted by the State in which the permanent establishment is situated and as well with other issues not yet clearly solved, such as the application and scope of the permanent establishment non-discrimination provision, the freedom of establishment, the tax avoidance and the treaty shopping.

4.- There are several types of atypical triangular cases which may arise in the daily transactions and some others that have been studied by scholars. This type of situations arise in dual resident cases, when income from employment in which an offshore permanent establishment provision applies, in cases of profits from international transportation and in cases of income derived by artistes and sportsmen. Each one of these situations gives place to different problems of determination of the applicable tax treaties and also of the interpretation that should be given to the clauses of such treaties.

5.- Although some solutions have been proposed by scholars and some decisions have been issued by some courts around the world, it is very difficult to propose a general solution applicable to every one of the existing triangular situations.

6.- With respect to the typical triangular situations, a solution is proposed in which upon the existence and recognition of a triangular situation, the non-discrimination clause of the treaty between the State of residence and the State in which the permanent establishment is situated is applicable. Once the non-discrimination clause is applied, the legal fiction of the permanent establishment acquires the right to be treated as a resident of the State in which it is set up and the legal relationship with the resident in the State of source is recognized, not only incorporating the right to apply the domestic

legislation of the State in which it is located but the treaty with the State of source from which it is receiving the corresponding attributable payment.

7.- With respect to atypical triangular situations, and bearing in mind that these cases arise in very special circumstances, as well a very specific solution is proposed. Accordingly, in the case of dual residents, the recognition of a triangular situation must take place and therefore the treaty between the Winner State and the State of source (in the case of dual resident as recipient) and the treaty between the Winner State and the State of the recipient (in the case of a dual resident as payor) should be applied

In the case of income from employment in which a permanent establishment offshore provision exists, the State considered as fictitious permanent establishment may perform bilateral negotiations to make prevail the offshore provision over the provisions of other applicable treaties.

Regarding the profits from international transportation, once again the recognition of a triangular situation in accordance with a definition either contained in the Commentary or in the Model Convention should be recognized, situation that could permit the States in which the place of effective management of a company is located to negotiate with other States the reservation of a right to tax, provided, of course that a triangular situation takes place.

Finally, pursuant the case of income derived by artistes and sportsmen, no concrete solution could be given but just to propose that either the Commentary or the Model Convention provide for a more certain application on the interpretation of Article 17(2) of the Model Convention in triangular situations, interpretation that may depend on the domestic law of the participating States.

It is remarkable to mention that although there are reasonable legal basis for these bilateral alternatives of solution to succeed, their implementation may be complicated and sometimes even far from reality. Their viability must be analyzed under the perspective of the international tax policies of negotiation.

However, scholars, practitioners and courts must keep on studying and developing solutions and ideas for the future solution and interpretation of this kind of cases that have become an important topic in the international tax and business community.

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Avery Jones, John F. *et al*., "Tax Treaty Problems relating to Source", *IBFD European Taxation* (March 1998), 78-93.
The authors consider the relevance of source in relation to taxing rights under the OECD Model Convention and the double taxation relief articles are also commented.

Avery Jones, John F. *et al.*, "The Non-Discrimination Article in Tax Treaties-I", *Reprinted from British Tax Review 10* (1991), 359-385.
Several characteristics of Article 24 of the Model Convention are analyzed, specially referring to the text of the provision.

Avery Jones, John F. *et al.*, "The Non-Discrimination Article in Tax Treaties-II", *Reprinted from British Tax Review 11 & 12* (1991), 421-452.
Several characteristics of Article 24 of the Model Convention are analyzed, specially referring to the text of the provision. The permanent establishment non-discrimination provision is analyzed.

Betten, Rijkele and Marco Lombardi, "Article 17(2) of the OECD Model in Triangular Situations. Does Article 17(2) apply if the artiste or sportsman is resident in a third State?, *IBFD Bulletin* (December 1997), 560-564.
The scope of Article 17(2) of the Model Convention is analyzed and the approach under which this provision must be interpreted is also commented.

Damen, Stephan, "Netherlands Supreme Court Rules on the Residence of Dual Resident Companies under Tax Treaties with Third Countries", *IBFD Bulletin* (July 2001), 290-292.

The decision hold by the Netherlands Supreme Court on 28 February 2001 is analyzed and the consequences of Article 4(1) of the Model Convention are also commented.

De Kort, Jan W.J., "HR 28 February 2001, nr 35.557: The Supreme Court of the Netherlands Reaches a Questionable Decision in a Triangular Dividend Withholding Tax Case", *29 Intertax 12* (2001), 402-406.
Several arguments are provided against the decision of the Netherlands Supreme Court of 28 February 2001.

Ganguli, Rohit, "Triangular Cases – Problems and Solutions", *ASSOCHAM International Tax Conference* (April 2003), 57-63.
A general and brief overview of triangular cases and their effects is made in this article. It represents a summary for the introduction of triangular situations.

García Prats, Francisco Alfredo, "Triangular Cases and Residence as a Basis for Alleviating International Double Taxation. Rethinking the Subjective Scope of Double Tax Treaties", *11 Intertax* (1994), 473-491.
Several arguments are proposed as the purpose of rethinking the scope of tax treaties concluded under unilateral basis. Some examples of dual residence are provided and some problems arising from triangular situations are analyzed in depth.

Kostense, H.E., "The Saint-Gobain case and the application of tax treaties. Evolution or revolution?, *EC Tax Review* (2000/4), 220-232.
The consequences of the Saint-Gobain case are studied with the contribution of the advantages and disadvantages of such resolution of the ECJ.

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A general overview of triangular cases is provided, making express reference to the double source taxation of interest and royalties under the OECD Model Convention.

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The origin of the problems arising from triangular cases is analyzed. As well, some cases and consequences are analyzed, providing an in depth study on this subject.

Nayak, Rajendra, "How much longer will Treaty Shopping be allowed?, *ASSOCHAM International Tax Conference* (April 2003), 48-56.
Treaty shopping is analyzed from the point of view of the abuse of source tax relief and the problems of treaty shopping are commented.

OECD. *Triangular Cases, Model Tax Convention: Four Related Studies* (Paris: OECD, 1992).
Report prepared by the OECD with respect to the analysis of the consequences and solutions to typical triangular cases.

Pijl, Hans, "The Fictitious Permanent Establishment Offshore in Dutch Domestic and Treaty Law", English translation of the article published in *Weekblad voor Fiscaal Recht* 2002/6500, at 1471 (2003), 1-23.

The author makes an analysis of the fictitious permanent establishment offshore provision both in Dutch domestic law and in treaty law, providing for examples of triangular cases arising from the application of this provision.

Sarno, Gian Marco, "Shipping, inland waterways and air transport under Article 8 OECD Model Convention", *LLM Paper for the LLM Program in International Taxation*, Leiden, The Netherlands (199-2000), 18 p.
A general overview of Article 8 is made. As well, a useful example of the application of Article 8 of the Model Convention is provided.

Smit, Pim M., "Treaty Residence of a Company in a Triangular Situation: Decision of the Supreme Court of 28 February 2001", *IBFD European Taxation* (April 2002), 155-158.
Once again the consequences of the decision of the Netherlands Supreme Court on 28 February 2001 are considered, especially the application of Article 4(1) of the Model Convention.

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Thuronyi, Victor, *Tax Law Design and Drafting* (Washington D.C., International Monetary Fund, 1998.
Several aspects of international taxation are provided in this book. Some essential concepts and principles of international taxation are well analyzed as it is the case of the source and residence taxation principles.

Van Raad, Kees, "Issues in the Application of Tax Treaty Non-Discrimination Clauses", *IBFD Bulletin* (August7September 1998), 347-351.
Several issues are discussed by the author, pointing out the consequences of the interpretation of the permanent establishment non-discrimination clause provided in Article 24(3) of the Model Convention.

Van Raad, Kees, "The 1992 OECD Model Treaty: Triangular Cases", *IBFD European Taxation* (September 1993), 298-301.
A brief but in depth analysis is made by the author with respect to the consequences arising basically from the typical triangular cases and from the dual residents cases.

Van Raad, Kees, "International: Dual Residence", *IBFD European Taxation* (August 1988), 241-246.
Several issues are analyzed with respect to dual residents either as subsidiaries or parent companies and some other aspects are commented regarding these atypical triangular situations.

Vogel, Klaus, *Klaus Vogel on Double Taxation Conventions* (London: Kluwer Law International, 1999), 1629 p.
One of the greatest publications on the interpretation and application of tax treaties. Several issues of triangular situations are commented along the publication.