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Triangular Tax Cases

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Triangular Tax Cases

edited by

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Series Editor's Preface

The postgraduate program in International Tax Law at the Vienna University of Economics and Business Administration is available either as a one-year full-time or a two-year part-time program. Students attend not only a vast number of courses, for which they prepare papers and case studies, and sit numerous examinations, they also write their Master's theses. These theses are a prerequisite for the academic degree "Master of Laws (LL.M.)".

The program follows a scheme under which the Master's theses of one particular program all discuss various aspects of the same general topic. The general topic of the 1999/2000 full-time program was "Electronic commerce and taxation", that of the 1999/2001 part-time program "Transfer pricing". We had selected "Partnerships in International Tax Law" as topic of the 2000/2001 full-time program, "Exemption and credit methods in tax treaties" for the 2001/2002 full-time program, „Permanent Establishments in International Tax Law“ for the 2002/2003 full-time program, and "Non-discrimination provisions in tax treaties" for the 2001/2003 part-time program. The respective Master's theses were published in edited volumes.

The general topic for the 2003/2004 full-time program was "Triangular Tax Cases". A common subject does not only encourage students to discuss their theses with each other, but also permits looking after the students in accompanying courses. Prof. *Kees van Raad* introduced the students to the subject matter at the beginning of the year. *Franz Philipp Sutter* and *Ulf Zehetner* held seminars in which the structure of the papers and the intermediary results were analyzed critically. It was with great commitment that they supported the students who prepared their Master's theses, and their numerous suggestions helped improve the quality of the Master's theses and, as a consequence, the quality of the present volume. In both of my functions as the scientific director of the postgraduate program and the editor of this series I wish to express my gratitude to the two colleagues.

I am grateful also to the students themselves. They pursued the program with great enthusiasm. This postgraduate program did not only give them the opportunity to talk to academics and scientifically qualified interns from all over the world and to acquire a wealth of knowledge, they also learnt how to tackle and solve complex issues using a structured approach. The Master's theses now available bear witness to this. I hope that the results of these papers will both influence the scientific discussion and be of use to tax practitioners.

Michael Lang

Preface of the Editors

An introduction into the legal problems of triangular tax cases

The Austrian marketing industry has used the picture of the “ménage à trois” already for decades to successfully promote products such as mineral water with the promise of more thrill and suspense in the life of their clients. The same “promise” probably holds true for trilateral tax situations as the involvement of three different countries brings about a lot of uncertainties and risks in treaty application on the one hand side, but can also be used for tax planning on the other hand side. The difficulties in the application of double tax conventions (DTCs) to multilateral situations result from the fact that DTCs are normally concluded on a mere *bilateral* basis and are therefore ignoring special trilateral issues.

Two major triangular cases can be distinguished: In the first triangular constellation, described in Part I of this volume and already subject of an OECD Report in 1992, there is a resident of State R earning income from a Source State S via a third country PE in State P. As Permanent Establishments are - according to the prevailing opinion - not treaty entitled under a standard DTC patterned along the OECD-Model, loopholes in the DTC protection arise in such a constellation. These loopholes can however be filled either via the St Gobain ruling of the ECJ in an EC framework or via a further development of an existing doctrine on an alternative construction of Art 4 para 1 MC on a global basis. Both ways and their remaining deficiencies are highlighted in this volume before the consequences of missing PE-treaty entitlement for standard cases are described in separate articles.

The second frequent root of triangular tax cases, dealt with in Part II of this volume, is the spread of dual resident corporations (DRC) in today’s business world. *Vis à vis* third (source) countries DRC enjoy the privilege of having two Residence States which gives them the opportunity to make use of the treaty networks of both States for invoking taxing restrictions in the Source country. In case of a parallel applicability of the DTCs R1-S and R2-S this leads to a somewhat peculiar situation: In order to avoid committing any treaty infringements the Source State has very likely to respect the more favourable restriction to the benefit of the taxpayer. Hence, identifying the “more favourable” restriction might be quite difficult in exceptional cases, as will also be shown in this volume.

The unlimited access to the treaty networks of both Residence States and the described “always better-off-position” of DRC has however been observed sceptically by members of the tax administration and some legal scholars. Therefore an alternative approach on the question of treaty residency of DRC has been developed that gives Art 4 para 1 last sentence of a possible DTC R1-R2 a new powerful meaning excluding DRC from treaty entitlement under all DTCs of the Secondary Residence State, ie the State losing the

residence status in relationship to the other Residence State R1. The consequences of such a far-reaching alternative construction of art 4 para 1 last sentence OECD-MC – that has already been adopted in some national court rulings - are currently analyzed on the OECD-level; in this book they are scrutinized from different angles of possible business situations of DRC in separate articles. The general adoption of this new approach would certainly revolutionize treaty law, as the existence of a DTC between R1 and R2 is then not necessarily to the benefit of the taxpayers, but can also be to their detriment.

Another issue to focus on when looking at DRC is the question of possible *non liquet*-situations in the application of the DTC R1-R2 as Art 4 para 3 OECD-MC currently just provides for the ‘Place of Effective Management’ as single tie-breaker test. Against the background of modern management developments this tie-breaker rule can’t settle all possible residence-residence conflicts anymore making amendments to the OECD-MC necessary. Part II of the book will therefore also take a look into the legal consequences of an inapplicable tie-breaker for the application of the DTC R1-R2 and present the current proposals of the OECD for changes to the Model Tax Convention.

In Part III of this volume we want to show the impact of trilateral situations on the organization of doing business by using domestic tools such as group taxation or holding structures where third country effects have to be taken into account from their setting-up on. Moreover, it will be demonstrated that the involvement of three different jurisdictions stiffens the problem of classification conflicts such as the ones on entity qualification already known from bilateral relationships. Special trilateral questions arise regarding the economically vital treatment of losses, as both domestic concepts and treaty approaches vary fundamentally between the various States. The consequences of these differences for triangular situations including cases of cross-border reorganizations are therefore closed up in this part of the book as well.

Part IV finally ought to depict that there are also a lot of trilateral tax constellations imaginable due to the risen mobility of individuals. This holds especially true for managers, artistes and lecturers travelling through various countries without a fixed working place. Above that, a special likelihood for multiple taxation exists in the field of inheritance and gift taxes where traditionally broad domestic taxing scopes meet very loose treaty networks. Our final Part V is dedicated to “Horizontal issues of triangular cases” discussing the relevance of the “Most favoured nation Concept” in triangular situations on the one hand side and of the various Treaty Shopping doctrines on the other hand side. Moreover, the US approach of limiting treaty benefits by special Treaty Clauses considering the tax situation in third countries will be analysed and the recent discussion about the possible importance of Art 27 MC for an exchange of information in trilateral situations will be introduced. Rounding off the study on triangular cases we will finally take a look on

unilateral double tax reliefs that can sometimes fill up the gaps of treaty application. In this context the Austrian example is of special interest as it provides – since recently – for strict rules when to give such a unilateral relief installing thereby a sort of “subsidiary global DTC” on a unilateral basis.

Against the background of the growing importance of triangular tax cases due to developments in international business, the complex legal issues pertaining to them and the lack of recent comprehensive coverage in legal science “Triangular Tax Cases” have been chosen as general topic for the Vienna LL.M. fulltime course 2003/2004 on International Tax Law. The advantage of starting such a research project in this framework is that it allows to gather a team of authors necessarily involved with all aspects of International tax law and equipped with best infrastructure and motivation to deliver a thorough study. In the light of the general topic the students – who are now the authors of the articles of this volume – have had the chance to reflect all their various courses of their study year in the light of the subtopics ascribed to them, to approach their experienced lecturers with special trilateral questions and to use breaks and informal coming-togethers among themselves for intense discussions, as they were all deliberating about related questions.

The editors’ task in this surrounding was to accompany the students on their way through the jungle of legal doctrine and to give guidance wherever necessary. In practice this meant that it was up to us to choose 21 subtopics we considered worth including in a comprehensive study on triangular tax cases. Above that we elaborated an extensive outline about potential problems that we associated with the various subtopics and that we wanted the students to deal with in any case. Three months after the distribution of the subtopics and a thorough library research of the students we re-gathered our team of authors for instructions on scientific writing as well as a first presentation of their preliminary findings. After an intense discussion and three more months we collected the articles and went critically through them giving the students numerous hints for further improvements, making them aware of eventual inconsistencies in their argumentation and pointing at different possible angles on the issues discussed. Then the students had another month for amending their articles in the way they considered it appropriate.

As the reader of this edited volume will soon recognize, each author has developed their own style in handling their subtopic. This is, however, a characteristic of any collection of articles of different authors and makes up its charm. Despite our “consultancy involvement” we were consequently neither able to nor wanted to alter this nature of the volume streamlining all articles along our own imaginations. Consequently, the responsibility for the various articles and the opinions expressed therein remains solely with the authors. Nonetheless, we can promise the reader from the work with the authors a fruitful and inspiring lecture on the complex issue of “Triangular Tax Cases” and are very proud of the turnout of the project. Therefore we are

confident that the publication of this book will both enrich the scientific debate and help practitioners to find their way through the related legal aspects. If these two goals are met – which has to be judged by our dear readers, our work was successful.

Finally, we want to dedicate this book – in our own names and in the ones of our authors – to our respective partners and beloved ones for showing the necessary understanding for our commitment and the inevitable investment of large parts of our freetime into scientific work as well as for giving us nonetheless their encouraging and vital support.

Franz Philipp Sutter

Ulf Zehetner

Table of Content

Series Editor's Preface	5
Preface of the Editors	7
Table of Content	11
List of Abbreviations.....	13

Part I. Triangular Cases involving Third Country Permanent Establishments

Bernd Langoth Treaty Entitlement of Permanent Establishments	19
Marco Antônio Gomes Behrndt Passive Income (dividends, interests or royalties) Received by a Permanent Establishment from a Third State	49
Christian Jakobsons Payment of Interest by a Permanent Establishment to a Third State Recipient.....	77
Alexander Stieglitz The Sub-Permanent Establishment in a Third State.....	99

Part II. Triangular Cases involving Dual Resident Companies

Mark Kalyagin and Richard Strnad The Importance and the Limits of the Tie-Breaker-Rule for Dual Resident Companies	129
Joachim Creus and Dennis de Jong Dividends Paid by Dual Resident Companies.....	145
Eva Frkalová and Maxim Sokolov Dividends Received by a Dual-Resident Company	173
Imke Gerdes Dual Resident Employers and Employees from Third States	195

Part III. The Impact of Trilateral Situations on the Organization of Doing Business

Daniela Hohenwarter Losses in Triangular Situations	219
Sashi Tulsian and Santiago Solórzano-Ureta Entity Classification in Trilateral Situations	263

Benjamin Twardosz Group Taxation in Triangular Cases.....	281
Albrecht Hobe Austria as Holding Location	317

Part IV. Triangular Cases involving “Mobile Individuals”

Sandy Taeymans and Barnabas Stubna Artistes and Artiste Companies in Triangular Situations.....	339
Petra Vrignaud Managers in Trilateral Situations and the Tests of Domestic Exercise and Exploitation.....	367
Christina Hauser Students, Researchers and Lecturers in Trilateral Situations	395
Karin Dartmann Gift- and Inheritance Taxation in Triangular Situations.....	415

Part V. Horizontal Issues of Triangular Cases

Koen Van Ende The Relevance of the Most Favoured Nation Concept in Triangular Situations	439
Juan Carlos Molina Treaty Shopping	467
Barbara Mair Limitation on Treaty Benefits by Special Treaty Clauses Considering the (Tax) Situation in Third Countries.....	491
Elke Theissl Exchange of Information in Trilateral Situations.....	513
Vanessa E. Metzler The Unilateral Double Tax Relief System of Sec 48 FFC in Triangular Situations	529
Index of Editors and Authors	559
Index by Keywords	565