Triangular Cases

(adopted by the OECD Council on 23 July 1992)

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I. INTRODUCTION

1. Double tax treaties are concluded on a bilateral basis. Specific problems may therefore arise in situations where more than two States are involved. Sometimes the solution is to apply the provisions of the treaties that are relevant. For instance, Article 4 of the Model Convention contains rules for the settlement of conflicts concerning residence when a person is a resident of several States and receives income from third States.

2. But the Model Convention does not provide any general and consistent solution to the problems raised by typical triangular cases, *i.e.* those in which:

- income from dividends, interest or royalties is derived from a source in State S;
- such income is received by a permanent establishment in State P;
- the permanent establishment depends on an enterprise resident in State R.

3. The purpose of this note is to analyse the difficulties to which triangular cases give rise in the three States concerned, to show countries' current practices and to discuss ways of dealing with the problem.

II. OUTLINE OF THE PROBLEM

A. *Practical importance of the typical triangular case*

4. The fact that many States have already encountered problems with this typical triangular case shows that the matter is of some practical importance. With growing international economic co-operation and, in particular, economic integration within the European Communities, it is to be expected that triangular cases will occur more frequently in the future. The banking and insurance sectors, for example, are directly concerned. Banks often have foreign branches that may receive interest from third countries on loans granted to residents of those countries. Also, branches of insurance companies located in countries other than that where their head office is established are sometimes required, under the law of the country where they are located, to have risk-cover capital. The income from this capital, which often consists of shares or bonds, may come from third States, in which case it is clearly attributable to the branch.

5. Also, industrial or commercial enterprises with permanent establishments in a number of countries may, for example, attach to one of them an industrial plant hired to a resident of a third State; if the attachment of the corresponding asset to the permanent establishment is normal, then the rent from the plant hire is clearly also attributable to it.

B. *Tax problems arising in the typical triangular case*

6. Problems will differ depending on whether State R taxes (subject to the deduction of a tax credit) or exempts from tax the profits of the permanent establishment located in State P, profits which include passive income from State S.

i) State R taxes the profits of the permanent establishment

7. If there is no tax treaty between the three States concerned, the enterprise has an unlimited tax liability in State R. The profits of the permanent establishment, including income from State S, are taxed in State P. State S can also levy withholding tax on income paid to the permanent establishment.

8. As to the question of whether, and how, double taxation is avoided on the permanent establishment's profits in general or on income from a third State, only the domestic law of each country is relevant.

9. The situation is different if double taxation treaties have been concluded between the States concerned. The purpose of these treaties is to avoid the double taxation of income by two States. They apply only to the residents of one Contracting State who receive income from the other State or who possess assets located in the other State. In addition, they lay down general rules concerning income from third countries.

10. The typical triangular case, however, involves three States. If each of them has concluded a treaty with the other two States in accordance with the Model Convention, the tax situation according to the Articles of the Model Convention and the Commentaries is as follows:

Situation for State S

11. For State S, dividends, interest or royalties are paid to a resident of State R; State S can therefore impose withholding tax as provided for in the R-S treaty. The fact that the payments are attributable to a permanent establishment in State P does not mean that the treaty between State R and State S is not applicable to State S. On the other hand, the treaty between State P and State S is not applicable, given that the permanent establishment is not a resident of State P.

12. The problems that arise in this context relate to procedure and endorsement: is it the enterprise or the permanent establishment that must claim withholding tax relief and by whom should such a claim be endorsed?

Situation for State R

13. For State R, both treaties (R-S and R-P) are in principle applicable: the treaty between State R and State S because the income comes from State S and goes to a resident of State R, and the treaty between State R and State P because the profits are those of a permanent establishment situated in State P. Let us suppose that State R taxes the profits of the permanent establishment, which include the income from State S, and grants a tax credit. Such a tax credit usually takes into consideration the taxes paid in State P. But under the R-S treaty, State R is also required to avoid double taxation. As a rule, when no triangular cases are involved, it does so by allowing the tax due in State S to be set against its own taxes on income from State S.

14. In a triangular case, State R must already grant a credit for the taxes paid in State P; the question then arises as to whether the taxes paid in State S and not credited in State P should also be taken into consideration. The problems of procedure and endorsement mentioned for State S also arise for State R.

Situation for State P

15. Under the treaty between State R and State P, State P can tax the profits that are attributable to a permanent establishment via which an enterprise of State R carries on an activity in State P. The dividends and interest from State S form part of these profits and are therefore taxable in State P. The question arises, however, as to whether State P should take into account a limited right of taxation of State S. Given that the treaty between State P and State S is not applicable, it does not seem that State P has any obligations arising from it, such as granting a tax credit in respect of the tax due in State S. Should State P, under the R-P treaty, grant such a credit on the basis, for example, of the provisions on non-discrimination contained therein?

ii) State R exempts the profits of the permanent establishment

16. This situation does not often arise when State R and State P are not bound by a tax treaty. It is more frequent when State R and State P have concluded a treaty. The Model Convention (Articles and Commentaries) provides no satisfactory solution to the problems of double taxation and tax avoidance that arise in this situation.

Problem of double taxation

17. State R does not tax passive income from State S either as such or as an item included in the profits of the permanent establishment located in State P. It therefore cannot grant a tax credit in respect of:

- tax levied in State S, if State P grants no credit in respect of that tax;

– or any possible difference between the amount of that tax and the amount of the credit granted in State P.

18. In other words, when the income is imposed both in State S and in State P (which is quite normal if neither State S nor State P is a tax haven), double taxation can be eliminated only by State P.

19. When State R and State P have signed a treaty according to the Model Convention, a literal interpretation[1] of paragraph 4 of Article 24 would mean that State P would have to grant a tax credit in the same way as it would to residents receiving dividends, interest or royalties from State S. This would, in certain cases, only partly solve the problem of double taxation, since the credit granted in State P (by virtue of the treaty between State P and State S) might be smaller than the tax charged in State S (by virtue of the domestic law of State S or of the treaty between State R and State S). But in such a situation the commentaries on paragraph 4 of Article 24 do not provide for the granting of a tax credit, and no other provision of the Model Convention can settle the double taxation problem.

Problem of tax avoidance

20. Most delegations consider that Articles 10, 11 and 12 of the treaty between State S and State R (supposing that the treaty follows the Model Convention) justify exemption or relief from tax on income in State S, even when that income is not liable to tax in State R (by virtue of that State's domestic law or of the treaty between State R and State P), and whatever the location of the permanent establishment receiving that income.

21. Clearly this interpretation gives banks and other enterprises in State R an incentive to place assets generating passive income in one of their permanent establishments in a State or Territory offering favourable tax treatment. So, far from closing a loophole, the Model Convention makes one available.

22. The problem is briefly referred to in paragraph 6 of the Commentary on Article 21, and it is suggested:

– either that an addition be made to paragraph 2 of Article 21, waiving the application of its provisions when income-generating assets are attached to a permanent establishment essentially in order to take advantage of paragraph 2 of Article 21 in the treaty between State R and State P;

– or that State R should not apply paragraph 2 of Article 21 of the R-P treaty when State R considers that the attachment of the assets concerned to the permanent establishment situated in State P is fictitious.

23. In certain cases, however, the first method suggested is extremely difficult, not to say impossible, to apply – for instance, to banks carrying out large numbers of transactions in many countries. The second method disregards States whose domestic legislation exempts from tax the profits made by permanent establishments located outside their territory. So, in fact, satisfactory solutions to the tax avoidance problem considered here still have to be found.

III. DISCUSSION OF POSSIBLE SOLUTIONS

24. First, it is necessary to examine the solutions provided for by the Model Convention and the Commentary. Next, the way countries have responded needs to be studied in order to see what solutions have been found. And, lastly, the advantages and drawbacks of the various possibilities have to be discussed.

A. *Discussion based on the Model Convention and Commentary*

25. The Commentary on the Model Convention mentions the problems raised by triangular cases in relation to Article 21, “Other income” (paragraphs 5 and 6 of the Commentary), Article 23, “Methods for elimination of double taxation” (paragraph 10 of the Commentary) and Article 24, “Non-discrimination” (paragraphs 52 to 55 of the Commentary). These comments did not appear in the Commentary on the 1963 Draft Convention.

26. When the 1963 Draft Convention was being revised , the problems raised by triangular cases were examined, particularly in respect of the following questions:

- What is the scope of the Article on non-discrimination?
- Is the permanent establishment in State P entitled to a tax credit, or even an exemption, in respect of income from State S?
- How large should this tax credit be?
- What are the formal requirements for the granting of relief?
- How can abuses be prevented?

27. At the time, member countries came to the conclusion that the problems involved in the typical triangular case were too complex to be dealt with in the actual wording of the Model Convention or Commentary. They therefore recommended that countries should prescribe ways of dealing with them in their bilateral treaties or settle them by mutual agreement.

B. *Practice in Member countries*

28. Since the Model Convention provides no solution to triangular cases, it is useful to see how member countries deal with them in practice. The replies to a questionnaire sent out to member countries are summarised below.

i) General

29. A large number of countries have already had to contend with triangular cases. Some of them (usually those which eliminate double taxation of the permanent establishment by the credit method) seem not to have met too much difficulty dealing with them. Others, however, have and these countries consider that a standard procedure should be included in the Model Convention or Commentaries. With respect to the problem of avoiding double taxation, States may find themselves in one of the following positions:

State P

30. Most of the countries which, as State P, apply the credit method under their domestic law for their own enterprises, also usually grant tax credits to permanent establishments of non-resident enterprises. *Ireland* and the *United Kingdom* grant it only in limited cases (branches of foreign banks for example). The obligation under paragraph 4 of Article 24 is not recognised by all the countries that grant a tax credit under their domestic law.

31. Some countries pointed out that a literal interpretation of paragraph 4 of Article 24 obliges a State to grant a tax credit even if its domestic law does not provide for such a grant to non-residents, since the treaty prevails over domestic legislation. Other States do not agree that such an obligation exists.

32. The first group of countries base their interpretation notably on rulings handed down by their own courts that paragraph 4 of Article 24 is sufficiently clear to be followed to the letter. Such literal interpretation certainly conflicts with paragraph 55 of the Commentary on paragraph 4 of Article 24. But as the Commentary has no legal or statutory force, they cannot be opposed to the rulings handed down by the courts, which consider that they enlarge on the wording of Article 24 rather than being simply interpretative commentaries.

33. Some countries consider on the basis of a decision of the Court of Justice of the European Communities that the principle of freedom of establishment enshrined in Article 52 of the Treaty of Rome requires that a branch be taxed in the same way as a subsidiary. This jurisprudence thus means, they argue, that a branch established in an EEC State and dependent on an enterprise with its headquarters in an EEC State, is entitled to the same tax credits as a subsidiary in the same circumstances.

34. Countries that do not come into one of the above-mentioned categories do not, as a rule, see any possibility of granting a tax credit to a permanent establishment because they consider that the treaty between State P and State S is not applicable. A situation thus arises in which double taxation is not eliminated by State P.

State R

35. States which, as State R, apply the credit method are usually willing to grant a tax credit in respect of tax levied in State P (based on the treaty between State R and State P) but also in respect of tax due in State S (based on the treaty between State R and State S) which has not been credited by State P. For these countries, therefore, the triangular case does not give rise to any particular problems concerning possible double taxation.

36. Countries which, as State R, apply the exemption method in respect of profits by a permanent establishment and grant credits for the taxes due on dividends, interest and royalties received directly from State S do not see any possibility of granting a tax credit based on a treaty between State R and State S because the income from State S is not taxed in State R. For the same reason, State R cannot take into consideration tax due that has not been credited by State P. In these cases, double taxation subsists unless it is eliminated by State P.

State S

37. As regards the situation of State S, virtually every country considers that the treaty between State R and State S is applicable and that tax relief must be granted on the basis thereof. If the claim has to be endorsed, residence as a rule has to be certified by the State R of which the enterprise is a resident.

38. However, certain States say these solutions are not appropriate when State R exempts from tax the profits of the permanent establishment, pointing out, in particular:

- That systematic application of the treaty between State R and State S is bound to incite enterprises in State R – especially banks – to attach income-generating assets to permanent establishments located in the countries which tax such income lightly or not at all. In some cases, such income would thus be exempted from tax in State S, State P and State R.
- That the endorsement procedure is intended, notably, to inform the tax authorities of State R about the nature, amount and source of income received by the taxpayer who requests a certificate of residence. But such information is of no interest to State R when it exempts from tax the profits of a permanent establishment situated

in State P, whereas it would be of interest to State P (unless it is a tax haven), so that State P should at least be concerned in the endorsement procedure.

ii) Position concerning the application of the treaty between State P and State S

39. Some countries consider that the treaty between State P and State S should be applied in triangular cases, either by an amendment to the Model Convention, or by the mutual agreement procedure. The majority of States are strongly opposed to such a solution, above all because such States fear it might encourage "treaty shopping", *i.e.* induce enterprises resident in States which exempt from tax the profits of permanent establishments located outside their territory to attach their income-generating assets to permanent establishments situated in those States that offer the most favourable tax treatment.

C. *Assessment of possible solutions*

i) Elimination of double taxation

The substantive problem

40. As we have seen, State R cannot eliminate double taxation when it exempts from tax the profits of a permanent establishment situated in State P. When it does tax those profits, the tax credit it can grant will usually be limited to the amount of the tax payable. If that amount does not exceed the amount of the tax levied in State P, State R cannot give a tax credit in respect of tax (or tax liability) in State S. Therefore, since State R often has little or no possibility of eliminating double taxation, a solution has to be sought in State P.

41. If State P grants tax credits under its domestic law to its own enterprises, it should also, according to some, grant them to permanent establishments of a resident of State R (see paragraph 51 of the Commentary on Article 24 of the Model Convention). When State P does not grant a tax credit under its domestic law, the question arises of whether it should do so under the treaty between State P and State S or the treaty between State R and State P.

Treaty between State P and State S

42. The Model Convention in principle concerns only residents in one or both States. As the permanent establishment situated in State P is resident in State R, the treaty between State P and State S, in the situation under

consideration, could be applied only if it provided expressly for the treatment of triangular cases.

43. This solution would mean that permanent establishments situated in State P would be treated like residents of State P with respect to the taxation of passive income they received from State S. They could thus put in their own claim for tax relief in State S; State P would have to endorse their claims and grant the same tax credit as to its own enterprises.

44. This method, which would introduce a new element into the treaties, has some advantages but also some drawbacks:

- The problem of tax credit would be solved. Permanent establishments would be treated on an equal footing with enterprises of State P; State P would be able to certify residence and control the taxation of income from State S.
- State S would have to grant the advantages provided for under the treaty concluded with State P to permanent establishments of third States with which it might have no treaty. But the treaty between State P and State S would thus work on the principle of reciprocity that prevails in tax treaties, and the quality of permanent establishment recognised in respect of the taxation of industrial and commercial profits would also have to be recognised in respect of the taxation of passive income.
- Enterprises of a State R would, in the absence of a treaty between State R and State S, be able, after setting up permanent establishments in State P, to take advantage of the treaty between State P and State S; or they might well be tempted to maintain permanent establishments in State P in order to take advantage of a withholding tax rate under the treaty between State P and State S lower than the rate under the treaty between State R and State S.

The danger of "treaty shopping" arises when State R eliminates double taxation of the permanent establishment's profits by the exemption method.

45. States which chose to apply the treaty between State P and State S in their bilateral relations could, for instance, add a provision to this effect to paragraph 4 of Article 24. This was done in a new treaty between *France* and *Italy* that was signed recently. The provision reads as follows:

> When a permanent establishment situated in one State receives dividends, interest or royalties from the other State corresponding to assets or rights effectively attached to its activities, that income shall be taxable in the State of source, in accordance with the provisions of Articles 10, 11 and 12 respectively. The State where the permanent establishment is situated shall eliminate double taxation by the method as provided for in Article … (the granting of a tax credit). This provision

shall apply whatever the location of the headquarters of the enterprise on which the permanent establishment depends.

46. A large majority of the member countries are opposed to such a solution because it departs too much from the principles underlying the Model Convention and current practices.

Treaty between State R and State P

47. If the treaty between State R and State P is applied, the double taxation problem can only be resolved if State P is obliged to grant to permanent establishments of State R the same treatment that it grants to its own enterprises.

48. For it to be clearly spelt out that permanent establishments in State P enjoy the same advantages as State P's own enterprises, it would have to be agreed that express reference to this treatment be made in the treaty between State R and State P. Possibly, for instance, it could be stipulated in the Article on non-discrimination that permanent establishments of enterprises of State R would be entitled, in the same way as residents of State P, to a tax credit in respect of income from third countries. The amount of the credit, however, would depend on the credit to which enterprises of State P would be entitled, *i.e.* it could not exceed the amount of the withholding tax under the treaty between State P and State S.

49. The following methods could be adopted when the rates of withholding tax under the treaty between State R and State S differ from those under the treaty between State P and State S:

- R-S rate lower than P-S rate:
  State P would have to grant a tax credit at the lower R-S rate in order to avoid granting credit in excess of the tax effectively levied in State S;
- R-S rate higher than P-S rate:

  State P would not grant a credit in respect of the whole amount of withholding tax levied in State S. Thus partial double taxation would subsist, except in those cases where it was eliminated by State R.

50. The method of granting in State P a tax credit for the tax (or some of the tax) levied in State S would involve, in particular, amending paragraph 55 of the Commentary on paragraph 4 of Article 24 of the Model Convention. However, to meet the needs of those countries which consider that the wording of this paragraph does not justify that method, paragraph 4 of Article 24 would also have to be amended by the addition of an express mention of the method(s) recommended in order to eliminate double taxation in triangular cases.

Procedure

51. As indicated above, the elimination of double taxation in application of the treaty between State P and State S would involve certification by the tax authorities of State P. Where the treaty between State R and State P was applied, certification would have to be endorsed by the tax authorities of State R. But for the reasons set out in paragraph 38 of this report, it is not satisfactory for State P to be left out of this procedure:

- first, because State R may issue a certificate that does not directly concern itself but may, on the contrary, provide a loophole for tax avoidance unless State R can be quite sure that the income concerned is taxed in the normal way in State P;
- second, because it is in State P's interest to be given an opportunity to endorse a certificate that informs it of the existence of income in respect of which an enterprise is requesting that the treaty between State R and State S be applied.

52. When the elimination of double taxation results from a combination of the provisions in the R-P and R-S treaties, a recommendation could be added to the Commentary on the Model Convention to the effect that State P, too, should take part in the endorsement procedure and that the information contained in the certificate should be ample enough to meet the requirements of State R and State P.

ii) Tax avoidance

53. The most difficult problem appears to arise in the situation where income arising in State S and paid to a permanent establishment in a tax haven would be taxed very little or not at all.

54. Countries which decided to include in their treaties arrangements to eliminate double taxation by applying the treaty between State P and State S would, of course, have to be careful not to do so if State P did not tax in the normal way income received from outside sources by permanent establishments located in State P.

55. Countries which follow the traditional approach and which apply the treaty between State R and State S may be confronted to the problem created by a permanent establishment situated in a tax haven. A recommendation could be added in the Commentary on the Model Convention, for instance that these countries:

- Include in the treaty between State R and State S a provision stipulating that the advantages of the treaty shall be extended to permanent establishments in third countries only on condition that the said permanent establishments pay tax in the normal way on the

income concerned. However, such a provision would provide a remedy only in the most flagrant cases of abuse, *i.e.* those situations where income from State S is not taxed at all or benefits from a specially favourable rate.

– Include in the treaty between State R and State S a provision whereby State S shall grant relief only on condition that it has also concluded with State P an agreement on the elimination of double taxation (or an agreement on administrative assistance). Relief could, if necessary, be restricted to the amount provided for in that agreement.
– Agree on a general provision enabling State S not to grant tax relief and State R not to certify residence in cases where improper use was being made of the treaty.

56. When an enterprise of State R sets up or transfers funds or activities to a permanent establishment in State P in order to take advantage of more favourable tax treatment there, State R may argue, on the basis of Article 7 of the Model Convention, that the income therefrom is not in fact attributable to that permanent establishment. State R may then tax the income from State S and refuse to endorse the permanent establishment's claims for tax relief.

57. Although this kind of action may not always be successful when the enterprise takes certain precautions in order to hide the fact that it is seeking to avoid tax, it could nevertheless be mentioned in the Commentary on the Model Convention.

IV. CONCLUSION

58. Most member countries would be interested in finding a solution to the problems that can arise in the typical triangular case. First, it is necessary to eliminate a certain amount of discrimination that exists in respect of permanent establishments, resulting from the fact that in some cases a credit is not granted in respect of tax due in State S. Second, typical triangular cases ought to be treated as consistently and uniformly as is compatible with the tax systems in force in the countries concerned. Experience shows that recourse to the mutual agreement procedure is not often practicable when three countries are involved.

59. This report suggests some methods which might make it possible to eliminate double taxation in most cases and to limit the risks of tax avoidance. These methods should be presented in the Commentary on the Model Convention.

V. RECOMMENDATION

60. Since the majority of member countries prefer, on the basis of the basic principle that the treaty applies only to residents of one or the other of the Contracting States, the solution referred to in paragraphs 47 to 50 and reject that referred to in paragraphs 42 to 46, the Committee recommends that the Commentary on the Model Convention be revised as follows:

Proposed changes to the Commentary[2]

1. Paragraph 19 of the Commentary on Article 10 is replaced by the following:

> 19. The paragraph does not settle procedural questions. Each State should be able to use the procedure provided in its own laws. It can either forthwith limit its tax to the rates given in the Article or tax in full and make a refund. *Specific questions arise with triangular cases (see paragraph 55 of the Commentary on Article 24)*.

2. Paragraph 9 of the Commentary on Article 11 is replaced by the following:

> 9. The paragraph lays down nothing about the mode of taxation in the State of source. It therefore leaves that State free to apply its own laws and, in particular, to levy the tax either by deduction at source or by individual assessment. *Procedural questions are not dealt with in this Article. Each State should be able to apply the procedure provided in its own law. Specific questions arise with triangular cases (see paragraph 55 of the Commentary on Article 24)*.

3. Paragraph 5 of the Commentary on Article 12 is replaced by the following:

> 5. The Article deals only with royalties arising in a Contracting State and paid to a resident of the other Contracting State. It does not, therefore, apply to royalties arising in a third State as well as to royalties arising in a Contracting State which are attributable to a permanent establishment which an enterprise of that State has in the other Contracting State (for these cases, *cf*. paragraphs 4 to 6 of the Commentary on Article 21). *Procedural questions are not dealt with in this Article. Each State should be able to apply the procedure provided in its own law. Specific questions arise with triangular cases (see paragraph 55 of the Commentary on Article 24)*.

4. The fourth and following sentences of paragraph 10 of the Commentary on Article 23 are deleted.

5. Paragraphs 52 to 55 of the Commentary on Article 24 are replaced by the following paragraphs 52 to 56:

> 52. *If in a Contracting State (A) in which is situated a permanent establishment of an enterprise of the other Contracting State (B) credit for tax levied in a third State (C) can be allowed only by virtue of a convention, then the more general question arises, as to the extension to permanent establishments of the benefit of conventions concluded with third States. This question is examined below, the particular case of dividends, interest and royalties being dealt with in paragraph 53 below.*
>
> ***F. Extension to permanent establishments of the benefit of double taxation conventions concluded with third States***
>
> 53. *When the permanent establishment in a Contracting State of a resident enterprise of another Contracting State receives dividends, interest or royalties from a third State, then the question arises as to whether and to what extent the Contracting State in which the permanent establishment is situated should credit the tax that cannot be recovered from the third State.*
>
> 54. *There is agreement that double taxation arises in these situations and that some method of relief should be found. The majority of member countries are able to grant credit in these cases on the basis of their domestic law or under paragraph 4 of Article 24. States that under their present legislation cannot give credit in such a way or that wish to clarify the situation may wish to supplement the provision in their convention with the Contracting State in which the enterprise is resident by wording that allows the State in which the permanent establishment is situated to credit the tax liability in the State in which the income originates to an amount that does not exceed the amount that resident enterprises in the Contracting State in which the permanent establishment is situated can claim on the basis of the Contracting State's convention with the third State. If the tax that cannot be recovered under the convention between the third State and the State of residence of the enterprise which has a permanent establishment in the other Contracting State is lower than that under the convention between the third State and the Contracting State in which the permanent establishment is situated, then only the lower tax collected in the third State shall be credited. The following addition to Article 24, paragraph 4 after the first sentence, is therefore proposed:*
>
>> *When a permanent establishment in a Contracting State of an enterprise of the other Contracting State receives dividends, interest or royalties from a third State and the right or the asset in respect of which the dividends, interest or royalties are paid is effectively connected with that permanent establishment, the first-mentioned State shall grant a tax credit in respect of the tax paid in the third State on the dividends, interest or royalties, as the case may be, but the amount of such credit shall not exceed the amount*

R (11)

calculated by applying the appropriate rate provided for under the convention with respect to taxes on income and on capital between the Contracting State of which the enterprise is a resident and the third State.

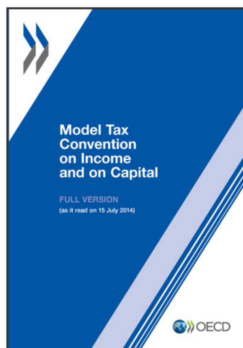
55. *Where a permanent establishment situated in a Contracting State of an enterprise resident of another Contracting State (the State of residence) receives dividends, interest or royalties from a third State (the State of source) and, according to the procedure agreed to between the State of residence and the State of source, a certificate of domicile is requested by the State of source for the application of the withholding tax at the rate provided for in the convention between the State of source and the State of residence, this certificate must be issued by the latter State. While this procedure may be useful where the State of residence employs the credit method, it seems to serve no purposes where that State uses the exemption method as the income from the third State is not liable to tax in the State of residence of the enterprise. On the other hand, the State in which the permanent establishment is located could benefit from being involved in the certification procedure as this procedure would provide useful information for audit purposes. Another question that arises with triangular cases is that of abuses. If the Contracting State of which the enterprise is a resident exempts from tax the profits of the permanent establishment located in the other Contracting State, there is a danger that the enterprise will transfer assets such as shares, bonds or patents to permanent establishments in States that offer very favourable tax treatment, and in certain circumstances the resulting income may not be taxed in any of the three States. To prevent such practices, which may be regarded as abusive, a provision can be included in the convention between the State of which the enterprise is a resident and the third State (the State of source) stating that an enterprise can claim the benefits of the convention only if the income obtained by the permanent establishment situated in the other State is taxed normally in the State of the permanent establishment.*

56. *In addition to the typical triangular case considered here, other triangular cases arise, particularly that in which the State of the enterprise is also the State from which the income ascribable to the permanent establishment in the other State originates (see also paragraph 5 of the Commentary on Article 21). States can settle these matters in bilateral negotiations.*

6. Paragraph 56 and following of the Commentary on Article 24 are renumbered accordingly.

Notes

1. Some member countries (*e.g. Ireland*, *Switzerland* and the *United Kingdom*) do not agree with such an interpretation.
2. Parts in italics indicate proposed additions.



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