Chapter 2

Triangular cases – the neglected problem in tax treaty law

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Nishit Desai is one of the leading tax experts in India, who is also globally active in the field of tax law. I was greatly impressed by his scientific interest during the numerous conversations I have had the privilege to have with him in recent years. He is one of those tax experts who are aware that good tax practices also require a sound theoretical backing. Accordingly, he puts a great emphasis on the training of his colleagues and their involvement with scientific issues. I consider this approach to be exemplary. Therefore, I hope to please the jubilarian by

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dedicating my contribution to one of the more complex topics of international tax law, that is, issues regarding triangular cases.

2.1 ARTICLE 15(3) OECD MC

DTCs constitute agreements between two states. They divide the taxation rights between these two states. They are not designed for trilateral, or even multilateral situations.[1] In practice, however, it is often the case that individual and legal persons have a connection to three or more states. As a result, several DTCs must be applied in parallel. In these cases, however, it often becomes evident that the application of various DTCs does not yield any satisfactory results.[2] I would like to illustrate this using the example of Article 15(3) OECD MC. This provision was amended by the 2017 OECD MC. Therefore, it is appropriate to use the opportunity to examine whether the application of this provision in a triangular case will now lead to more satisfactory results than in the past.[3]

I would like to base my considerations on the example of the following case:[4] A flight attendant is resident in State A. He is employed by an airline which is resident in State B but does not have a permanent establishment in any of the other states. He works for this airline in State C, on flights between two cities situated within State C. He works there for more than 183 days during a twelve month period. The question here is which of the States is entitled to tax the income of the flight attendant.

Further considerations may concentrate on the DTCs concluded by State A, since the DTC concluded between State B and State C is not

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1 See Lang, Dreifache Nichtbesteuerung als Ergebnis der Anwendung von Doppelbesteuerungsabkommen, *Steuer und Wirtschaft International* 2015, p. 198.

2 Also in this context van Raad, Triangular Cases, *European Taxation* 1993, pp. 298 et seq.; Staringer, Triangular Cases, in Gassner/Lang/Lechner (eds.) *Aktuelle Entwicklungen im Internationalen Steuerrecht* (1994), pp. 67 et seq.; Wassermeyer, Triangular Cases in Treaty Law, *Steuer und Wirtschaft International* 1999, pp. 520 et seq.; Haase, Mehrstaatensachverhalte und Art. 15 OECD-MA, *Internationales Steuerrecht* 2014, pp. 237 et seq.; Haase/Nürnberg, Die Anwendung von DBA auf Dreiecksachverhalte unter besonderer Berücksichtigung von Einkünften nach Art. 15 OECD-MA, *Internationales Steuerrecht* 2019, pp. 500 et seq.

3 See further *De Broe/Luts,* Taxation of Remuneration from Employment aboard a Ship or Aircraft Operated in International Traffic: Interpretation Issues under Article 15(3) of the OECD Model, *Bulletin for International Taxation* 2017, pp. 154 et seq.

4 Compare to a similar constellation Mooij, Netherlands Court of Appeals Decides against Taxpayer in a Triangular Case Involving the Taxation of Ship Employment Income, *Bulletin for International Taxation* 2012, pp. 151 et seq.

applicable. After all, the flight attendant is not resident in any of the two States. Consequently, this treaty does not meet the personal scope of Article 1 OECD MC. One could argue on the basis of the version of the OECD MC preceding the 2017 update that Article 15(3) OECD MC – in contrast to the first two paragraphs of Article 15 OECD MC and the version of Article 15(3) OECD MC in force since the 2017 update – does not expressly mention the residence of the recipient of the income as a precondition. Article 1 OECD MC already makes it clear, however, that the treaty only applies to persons who are residents of one or both of the Contracting States. There is no reason to assume that Article 15(3) OECD should be interpreted as an exception to Article 1 OECD MC.[5]

2.2 ARTICLE 15(3) OECD MC IN THE VERSION PRECEDING THE 2017 OECD MC

2.2.1 The DTC between A and B

The DTC between A and B is applicable. The flight attendant is resident in State A and therefore falls within the personal scope of all DTCs concluded by State A, including the DTC between States A and B. According to Article 2 OECD MC, the DTCs also cover taxes on income, so that this requirement for the income received by the flight attendant is also met.

Subsequently, the question arises as to the relevant distributive rule. Since the flight attendant – also for the purposes of tax treaty law[6] – is employed by the airline, income from employment within the meaning of Article 15 OECD MC also applies here. Though Article 15(2) OECD MC has priority over the first paragraph, Article 15(3) OECD MC has priority over both of the first two paragraphs.[7] By contrast, in case of applicability of Article 15(3) OECD MC *De Broe* and *Luts* recommended to apply the first two paragraphs of Article 15 OECD MC in addition to this provision. Their primary argument in favour of doing so was that Article 15(3) OECD MC distinguishes itself from the other preceding paragraphs of Article 15 OECD MC by the word "notwithstanding", while in other cases

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5 See also De Broe/Luts, supra note 3, pp. 165 et seq.

6 To the criteria in more detail, see Lang/Zieseritsch, Der Begriff der unselbständigen Arbeit nach Art 15 OECD-MA, in Gassner/Lang/Lechner/Schuch/Staringer (eds.), *Arbeitnehmer im Recht der Doppelbesteuerungsabkommen* (2003) pp. 31 et seq.

7 Kreutziger, Besonderheiten bei der internationalen Besteuerung von Schifffahrts- und Luftfahrtunternehmen, in Kaeser, *Festgabe Wassermeyer* (2015) m.no. 14; De Broe/Luts, supra note 3, pp. 164 et seq.; Wassermeyer, *DBA-Kommentar* (2019) Article 15 m.no. 181.

the term "subject to" is used. The terminology within the OECD MC, however, is consistent: The word "notwithstanding" can be found in articles or paragraphs of the OECD MC which claim priority over other provisions, while the expression "subject to" is mentioned in those articles and paragraphs of the OECD MC which give precedence to the other provisions mentioned before them. Article 19(2)(a) OECD MC can also serve as an example for a provision that uses the word "notwithstanding" and at the same time allocates the exclusive taxing right to the source State – in this case, to the State of the political subdivision or local authority to which the services were provided. Despite the use of the word "notwithstanding", no room would be left at all for a simultaneous application of other provisions. In addition, Article 15(3) OECD MC constitutes an independent distributive rule: Income from employment is – as the reference in Article 15(3) OECD MC shows – distributed over several articles of the OECD MC and over several paragraphs within Article 15 OECD MC. As with all other distributive rules of the OECD MC, these rules must be delimited so as to avoid an overlapping of their scopes. A simultaneous application of Article 15(3) OECD MC with other distributive rules for income from employment does not fit into the system of the OECD MC. Therefore, it must be assumed that Article 15(3) OECD MC takes precedence over the other paragraphs of this article. Consequently, one must first examine whether Article 15(3) OECD MC is applicable.[8]

The employment is exercised aboard an aircraft.[9] It must be examined whether this aircraft "is operated in international traffic". This is determined by Article 3(1)(e) OECD MC.[10] Accordingly, the term "international traffic" means *"any transport by a […] aircraft operated by an enterprise that has its place of effective management in a Contracting State, except when the […] aircraft is operated solely between places in the other*

8 To the question of whether the provisions of Article 15(1) and (2) can be invoked in the event that Article 15(3) OECD MC is inapplicable, see German *Bundesfinanzhof*, 5 September 2001, I R 27/0; Kreutziger, Internationale Besteuerungsprobleme bei Schifffahrtsunternehmen, in Grotherr, *Handbuch der internationalen Steuerplanung* (3rd ed.; 2011) pp. 1395 et seq.; Wassermeyer, supra note 7, Article 15 m.no. 182.

9 On the interpretation of the concept of "exercised aboard a ship or aircraft", see Prokisch, in Vogel/Lehner, *DBA-Kommentar* (6th ed.; 2015) Article 15 m.no. 107; Waser, in Aigner/Kofler/Tumpel (eds.), *DBA-Kommentar* (2nd ed.; 2019) Article 15 m.no. 101.

10 More on the definition 3(1)(e) OECD MC, see *Lang*, The Definition of International Traffic under Article 3(1)(e) of the OECD Model Convention, in Jochum/Essers/Lang/Winkeljohann/Wiman, *Practical Problems in European and International Tax Law* (2016) pp. 215 et seq.

Contracting State".[11] In the case under consideration, the aircraft is operated by an enterprise that has its place of effective management in a Contracting State, i.e. with its effective management in State B. The exception provided for in the last part of Article 3(1)(e) OECD MC is not applicable. This is because the aircraft is not operated solely between places in the other Contracting State – this would have been State A – but exclusively between places in a third State (State C). Therefore, it constitutes "international traffic" within the meaning of Article 3(1)(e) OECD MC.[12] As a result, Article 15(3) OECD MC is applicable. The remuneration is taxable in State B, in which the place of effective management of the enterprise is situated.

The method article will now decide how double taxation will be avoided in the relation between A and B. Where the States agreed on the exemption method in accordance with Article 23 A OECD MC, State A must exempt the income from taxes under a progression proviso. If they agreed on the credit method, however, State A may also impose taxes. The tax levied in State B must then be credited in State A.

2.2.2 The DTC between A and C

The DTC between A and C is also applicable. The flight attendant is resident in State A and can therefore benefit from the advantages of this DTC. The material scope of the DTC is also fulfilled: Article 2 OECD MC covers taxes on income.

Again, the question regarding the distributive rule arises. The application of Article 15(3) OECD MC depends on whether the aircraft "is operated in international traffic". In this case, Article 3(1)(e) OECD MC is relevant. For the purposes of this provision, the enterprise must have its place of effective management in a Contracting State. The enterprise at hand, however, has its place of effective management in State B. State B is not a Contracting State. Therefore, for the purposes of the treaty between States A and C, no "international traffic" takes place. This is also confirmed in the legal consequence mentioned in Article 15(3) OECD MC: According to this provision, the taxation right belongs to the

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11 The term "solely between places in the other Contracting State" means that both the point of departure and the point of arrival must be in that other Contracting State, see also Kofler, in Reimer/Rust, Klaus Vogel on Double Taxation Conventions (4th ed.; 2015) Article 8 m.no. 25; German *Finanzgericht Berlin-Brandenburg*, 24 January 2019, 8 K 8286/17.

12 For the various case constellations in which "international traffic" is involved, see *De Broe/Luts*, supra note 3, pp. 156 et seq.

Contracting State in which the place of effective management of the enterprise is situated. Yet the place of effective management is situated in a third State (State B), which is not a Contracting State under the DTC between States A and C. Since in DTCs the Contracting States distribute taxing rights between themselves, it cannot be assumed that a bilateral DTC will allocate taxing rights to a third State.[13]

Subsequently, the question therefore arises as to whether Article 15(2) OECD MC is applicable. This rule constitutes an exception from the taxation in the State where the employment is exercised, as prescribed in Article 15(1) OECD MC. When three requirements are met, income shall be taxable only in the residence state, although the employment was exercised in the other Contracting State. The last two requirements would not be responsible for failing to do so: The remuneration was paid by, or on behalf of, an employer who is not a resident in the other State. The other State would be State C. The employer, however, is resident in State B and therefore not in State C. The fact that, for the purposes of the DTC between States A and C, the employer is resident in a third State under this provision, does not constitute an obstacle.[14] Moreover, the remuneration is not borne by a permanent establishment that the employer maintains in the other State – that is, in State C. According to the case under consideration, the airline does not even have a permanent establishment in State C. Therefore, the remuneration cannot be borne by such a permanent establishment. Yet Article 15(2) OECD MC fails to apply because of the first requirement: The flight attendant is present in State C for more than 183 days in a twelve-month period.[15] Therefore, Article 15(2)(a) OECD MC – and thus Article 15(2) OECD MC as a whole – is not applicable.

As a result, the only remaining option is the application of Article 15(1) OECD MC. This provision allocates the exclusive taxing right to the residence state, unless the employment is exercised in the other Contracting State – in the case under consideration, State C. This is the

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[13] See also *De Broe/Luts*, supra note 3, pp. 167 et seq.

[14] De Broe, in Reimer/Rust, supra note 11, Article 15 m.no. 251.

[15] For more details concerning the 183-days-rule of Article 15(2) OECD-MA, see Lechner/Muszynska, Die 183-Tage-Regel im DBA-Recht, in Gassner/Lang/Lechner/Schuch/Staringer (eds.), *Arbeitnehmer im Recht der Doppelbesteuerungsabkommen* (2003) pp. 155 et seq.; Dziurdź, Kurzfristige Arbeitnehmerüberlassung im Internationalen Steuerrecht (2013) pp. 78 et seq.; *De Broe* in *Reimer/Rust*, supra note 11, Article 15 m.nos. 179 et seq.

case here. According to the last sentence of Article 15(1) OECD MC, the remuneration obtained from such employment is taxable in State C.

Again, the method for the elimination of double taxation will depend on the agreement reached between States A and C in their DTC: In case the exemption method under Article 23 A OECD MC applies, State A must exempt the income from taxes under a progression proviso. State A cannot tax such income. In case the States agreed on the application of the credit method under Article 23 B OECD MC, however, State A may also impose taxes. In this case, State A must credit the tax levied in State C.

2.2.3 Interaction between the two DTCs

It has been shown that, under both DTCs, the respective source state shall have the taxing right. Therefore, State B and State C can definitely tax the income. The responsibility for avoiding double taxation lies with the residence state. In this respect, whether and how double taxation can be avoided will depend on the DTCs concluded by State A with the two other States.

If both DTCs provide for the exemption method, State A cannot levy any taxes – except for the progression proviso. As a result, however, double taxation will remain in place: The income can be taxed in State B and State C. The DTC is not applicable in the relation between these two States and, consequently, double taxation cannot be avoided either.

If the exemption method applies under one of the applicable DTCs and the credit method under the other DTC, the result remains the same:[16] Due to the exemption from taxation under one of the two DTCs, State A cannot tax the income. As a result, however, the obligation to credit the foreign tax provided for in the other DTC would be to no avail: If State A does not levy any taxes, it cannot credit any taxes either. It would make no difference even if the flight attendant had additional sources income, for which State A has the taxing right and therefore additional "credit potential". This is because the maximum tax credit provided for in Article 23(1) B OECD MC would render such crediting impossible: The deduction shall not exceed that part of the income tax as computed before the deduction is given, which is attributable to the income which may be taxed in the other State.[17] Due to the exemption under the other

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16 The same problem may arise in certain constellations with respect to profits from permanent establishments, see also Staringer, supra note 2, pp. 74 et seq.

17 For the maximum deduction amount, see Schuch, Ausländische Steuern und Anrechnungshöchstbetrag, *Steuer und Wirtschaft International* 1994, pp. 156 et seq.; Schuch, *Cont...*

DTC, no taxes are imposed in State A on the remuneration received by the flight attendant. Therefore, the double taxation of the income in State B and State C remains in place.

If both DTCs provide for the credit method, the obligation to credit the taxes levied in States B and C lies with State A. As a rule, however, this will not yield any satisfactory results either: If one assumes that the tax burden is roughly similar in the three States – for instance, 30% in each –, the obligation under the DTC to credit the tax of the one State results in a situation where ultimately no taxes are levied in State A. As a result, however, the obligation provided for in the other DTC to credit the tax is to no avail. Though no tax is levied in State A, as a result, the income is nevertheless subject to double taxation, that is, in State B and State C. This does not change if the tax burden in State A is lower than in each of the two other States, or even when it is higher. Ultimately, there will be no taxation in State A, yet with double taxation in State B and State C remaining in place. If the tax burden in State A is higher that the tax burden in States B and C combined, the result will be that taxes will ultimately have to be paid in State A as well.

Paradoxically, even constellations with a de-facto triple non-taxation cannot be completely ruled out: Though State B has the taxing right under the DTC, in the case of non-residents some states avail themselves of this taxing right only when the activity is performed on their territory.[18] Depending on the national law of State B, it is possible that the mere residence of the employer in State B will not trigger any taxation. For State C, on the other hand, it can be difficult to collect taxes which result from an existing tax liability there, since there is no domestic employer who can be held liable. If the flight attendant does not declare his income there, State C may lack information about his activity and may have no possibility to enforce the collection of the taxes. If, in addition to that, one of the applicable DTCs provides for the exemption method, the income is not subject to any tax in State A either: According to the OECD MC, the exemption in the residence state does not depend on whether a tax liability exists in the other Contracting State, nor on whether the

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Der Anrechnungshöchstbetrag, in Gassner/Lang/Lechner, *Die Methoden zur Vermeidung der Doppelbesteuerung* (1995) pp. 11 et seq.; Bendlinger/Kofler, in Bendlinger/Kanduth-Kristen/Kofler/Rosenberger, *Internationales Steuerrecht* (2nd ed.; 2019) pp. 941 et seq.

18 See *De Broe/Luts*, supra note 3, pp. 164 et seq.

income recipient complies with his obligations and declares his income there.

2.3 ARTICLE 15(3) OECD MC IN THE 2017 OECD MC VERSION

2.3.1 The DTC between A and B

The 2017 OECD MC changed both the wording of Article 15(3) OECD MC and also the definition of international traffic in Article 3(1)(e) OECD MC.[19] However, the provisions on the personal and material scope of the OECD MC – at least with regard to individuals – have remained the same.[20] Consequently, the DTC between A and B is applicable to the remuneration of the flight attendant.

Again, for the purposes of Article 15(3) OECD MC, the deciding factor is whether the aircraft "is operated in international traffic". What is new, however, is the exception in Article 15(3) OECD MC, according to which this provision is not applicable if the aircraft is operated solely between places in the other Contracting State (State B). Yet this exception does not come into effect, since the aircraft is operated solely between places in a third State (State C).

Article 3(1)(e) OECD MC redefines the term "international traffic": The term now means any transport by a ship or aircraft except when the ship or aircraft is operated solely between places in a Contracting State and the enterprise that operates the ship or aircraft is not an enterprise of that State. Since the employer is resident in State B and is therefore an enterprise of State B, the exception would only come into effect if the aircraft were operated solely between places in State A – a Contracting State. Yet this is not the case, since the aircraft is operated solely between places in State C. Consequently, "international traffic" does apply here for the purposes of Article 3(1)(e) OECD MC. As a result, Article 15(3) OECD MC is also applicable.

The legal consequence provided for in Article 15(3) in the 2017 OECD MC differs from the previous provision: According to the current provision, the residence state of the flight attendant has the exclusive taxing right. Therefore, in the case under consideration, only State A may

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19 See also Bendlinger/Kofler, in Bendlinger/Kanduth-Kristen/Kofler/Rosenberger, supra note 17, pp. 842 et seq.

20 On the main changes in the OECD MC 2017, see Bendlinger, Das OECD-Musterabkommen 2017, *Steuer und Wirtschaft International* 2017, pp. 450 et seq.

impose taxes according to the DTC between States A and B. The taxing right of State B is already ruled out by the distributive rule.

2.3.2 The DTC between A and C

The amendments made in the 2017 OECD MC do not have any impact on the personal and material scope of the DTC, at least with regard to individuals. Therefore, the flight attendant continues to fall under the DTC concluded between State A and State C.

Again, according to Article 15(3) of the 2017 OECD MC, the deciding factor is primarily whether the aircraft "is operated in international traffic". Here, the – new – definition of Article 3(1)(e) OECD MC is relevant. "International traffic" means any transport by aircraft except when the aircraft is operated solely between places in a Contracting State. This exception comes into effect since the aircraft is operated solely between places in State C, and State C is one of the two Contracting States. Another exception that must apply here is that the enterprise that operates the aircraft is not an enterprise of this State. Since the airline is an enterprise of State B, this requirement is also met. After all, the second exception provided for in Article 3(1)(e) OECD MC also applies when the enterprise operating the aircraft is an enterprise of a third State.[21] As a result, "international traffic" does not apply here.

Article 15(3) of the 2017 OECD MC, however, provides for an additional exception: Even if the aircraft is operated in international traffic, this provision does not come into effect if the employment aboard an aircraft was exercised solely within the other Contracting State. Although this exception would also be applicable since the employment was exercised solely in State C, this exception is not relevant, because "international traffic" does not apply here anyway. Therefore, Article 15(3) OECD MC is not applicable.

The provision of Article 15(2) OECD MC was not amended by the 2017 OECD MC. Therefore, it is still the case that the last two requirements of Article 15(2) OECD MC are met: The employer is not resident in the

[21] M.no. 6.1 of the OECD Model Commentary on Article 3(1)(e) OECD MC 2017 states the following in this regard: "The definition was amended in 2017 to ensure that it also applied to a transport by a ship or aircraft operated by an enterprise of a third State. Whilst this change does not affect the application of Article 8, which only deals with profits of an enterprise of a Contracting State, it allows the application of paragraph 3 of Article 15 to a resident of a Contracting State who derives remuneration from employment exercised aboard a ship or aircraft operated by an enterprise of a third State". See also Bendlinger/Kofler, in Bendlinger et al, supra note 17, p. 843.

other State, but in a third state (State B). The remuneration is not borne by a permanent establishment that the employer maintains in the other Contracting State (State C), because the employer does not have a permanent establishment there. However, the application of Article 15(2) OECD MC fails – as a whole – because of the first requirement: The flight attendant exercises his activities in State C for more than 183 days in a twelve-month period.

Consequently, Article 15(1) OECD MC is applicable. According to this provision, the residence state (State A) has the exclusive taxing right unless the employment is exercised in the other Contracting State. This is the case here. As a result, State C may tax the remuneration. The taxing right of the residence state (State A) is not yet ruled out as a result.

Again, the manner in which State A will eliminate double taxation will depend on the method article of the DTC between A and C: If the DTC provides for the exemption method, State A must exempt the income from taxation under a progression proviso. If the credit method was agreed, State A can levy taxes, and must at the same time deduct the tax charged in State C.

2.3.3 Interaction between the two DTCs

The amendments made in the 2017 OECD MC also lead to another overall result: According to the DTC between State A and State B, State B has no taxing right. Under the DTC concluded between States A and B, the residence state (State A) has the exclusive taxing right. This consequence arises regardless of the method provided by the DTC between A and B for the elimination of double taxation. It is not at all necessary to apply the method article.

Therefore, State C is the only one of the two "source states" that maintains its taxing right. In the relation between States A and C, double taxation can thus be avoided in a conventional manner: If the DTC between States A and C provides for the exemption method, the income may be taxed only in State C – with the exception of the progression proviso. Within the scope of the credit method, State A has both the taxing right and, at the same time, the obligation to deduct the tax levied in State C. This ultimately poses no problem: In this case, there will be no double obligation to credit taxes, nor there will be an exemption due to the DTC between States A and B, on the basis of which crediting under the DTC between States A and C would be to no avail.

Likewise, the risk of a de-facto non-taxation is lower: According to the DTC between State A and State B, State B already has no taxing right. Therefore, it does not really matter if State B were not able to make use of such a right at all under its national law. Though State C may still have difficulties in effectively enforcing the tax obligation in place there, non-taxation would still only be possible if the DTC between A and C foresees the exemption method for income under Article 15(1) OECD MC.

2.4 CONCLUDING SUMMARY

Triangular cases continue to be among the most difficult issues in DTC application. The aforementioned considerations, however, show that the OECD has at least succeeded in eliminating the above problems in the scenario described here. Taxation in both "source states" is now no longer possible – provided that the DTCs are modelled on the OECD MC. Therefore, the 2017 OECD MC did not only introduce a few legally controversial amendments, it also eliminated – almost unnoticed – at least one of the previous application problems through careful "technical fine-tuning".