Residence in tax treaties

Sepúlveda Ramirez, J.F.

PART IV

MULTIPLE RESIDENCE AND THE TIE-BREAKER

12. Chapter 12
Dual residence conflicts in the OECD MC

12.1. Introduction: Multiple tax liability in the application of treaties

Residence in tax treaties is based on the provisions of domestic law, and this implies the acceptance of the fact that a person may be a resident of multiple States for tax treaty purposes. The OECD MC takes care of this issue by laying down some rules according to which this *tie* between States is broken, and these rules operate on the basis of the distinction between entities and individuals.

This section examines the issue of multiple residence in the OECD MC. By considering the conclusions arrived at in other parts of this study, dual residence is explored in general, from the standpoint of the Model and its history, to set out the interpretation of Art.4(2) and (3) of the OECD MC. This part also delves into the rules for individuals in order to examine each of the tests that are meant to break the tie in such a case. Further, it also includes an examination of the tie-breaker for entities and the manner in which the changes to the Model proposed in 2015 modify the determination of their residence.

12.2. Dual residence in Art.4 OECD MC

12.2.1. Dual residence 'by reason of the provisions of paragraph 1'

As has been stated before, the dual residence conflict arises because the OECD MC defines treaty residence through domestic residence, and because the application of the Model forces one to get to a situation in which there is only one State which has the primary right to tax. The tie, if it exists, needs to be broken for the Model to be applied:

> "The special point in these cases is only that no solution of the conflict can be arrived at by reference to the concept of residence adopted in the domestic laws of the States concerned. In these cases special provisions must be established in the Conventions to determine which of the two concepts of residence is to be given preference."[988]

The existence of a tie is given by the presence of a person who qualifies as a resident in both States "by reason of the provisions of paragraph 1". This suggests that there is an actual definition of residence in Art.4(1) OECD MC, by reason of which a person needs to be a resident in both contracting States, as has been stated repeatedly across this study. The rule of Art.4(1) OECD MC describes a generic submission to a State's tax authority, which is based on subjective attributes and regardless of the income a person derives. This is the definition of residence to which Art.4(2) and (3) make reference when instructing the interpreter to break the residence tie.

The problem is also relevant if one considers that a person may shift its residence within the same taxable period[989]. This question was explored extensively in the *Smallwood* case[990]. After residing during part of the year in one State, a person moved its residence to a different State for the rest of

---

[988] Sec.5 of Comm. to Art.4 OECD Model Convention (2014).
[989] See *moment of tax liability* in Chapter 6, supra at pp.66ff.
[990] See *Smallwood*, supra note 307.

the year. Under their domestic laws, both States claimed the right to tax the person as a resident for the entire period. Accordingly, having received income during the period of residence in the first State, both States nonetheless claimed the right to tax that income as the State of residence[991]. Despite the fact that the person was not a dual resident at the exact time of receiving the income, both States justified their tax claims because the person was considered to be 'liable to tax' by them, even if at different times, for the entire taxable period. Although the taxpayer argued the need to look at the situation at the precise moment the income was received, using a snapshot approach[992], the court disregarded the argument, and treated the taxpayer as a dual resident[993].

The Commentaries propose the opposite interpretation of the rule of Art.4 OECD MC. Arguably, this interpretation seeks to create a standard for domestic residents, according to which the treaty claimant needs to be treated as a treaty resident in each State only for the relevant section of the taxable period[994]. Yet the fact that residence is conceived as a domestic and a subjective[995] attribute in the Model supports the reasoning of the courts, and so does the idea that the Model seeks to impose no standards for domestic residents to access the Model. That being the case, it is relatively clear that the dual residence conflict arises even in the absence of simultaneous residence in two States[996]. The domestic character of tax liability, one may easily conclude, increases the potential for dual residence conflicts to arise. While arguments may be presented against the convenience of this reasoning, it is the spirit of the Model, after all, which gives preference to what the laws of the States define as relevant domestically in the context of tax liability at any given time.

12.2.2. A definition of residence and the tests in the tie-breaker[997]

The question of whether there is a definition of residence in Art.4(2) and (3) OECD MC and the question of whether the terminology used in these provisions needs to be defined at the international or at the domestic level are two questions which, despite representing different concerns, are intertwined in a series of aspects. It may be relevant to highlight that, historically, the purpose behind the creation of the tie-breaker was to introduce a treaty definition of residence, capable of superseding the domestic ones, precisely to give preference to one over the other:

> "[the dual residence issue] must, and only can, be solved by agreement on the application of a preference criterion laying down which of the two countries is to take priority with respect to their claims for tax based on their internal legislation concerning domicile and *thereby limiting the national concepts of domicile of the two countries*."[998]

The quest for a definition of residence arose precisely, and only because of, the dual residence conflict. As has been explained in other parts of this study, Art.4 OECD MC was conceived as a

---

991 In the Special Commissioners' opinion in the Smallwood case: "we do not consider that "by reason of…residence" means solely past or current residing. If residing in a subsequent period causes residence for the whole year, then liability is by reason of residence", *Smallwood*, supra note 18, at para.102.

992 What was called by the defendant a 'snapshot approach', see *Smallwood*, supra note 307, at para.65.

993 Lemos, supra note 217, at pp.620-621.

994 Sec.10 of Comm. to Art.4 OECD Model Convention (2014).

995 This would have been avoided if tax liability was analysed on the basis of the income instead of the person, see Wheeler's analysis of the Smallwood case in Wheeler, supra note 11, at pp.125-131.

996 Although Sasseville does not agree, Sasseville, supra note 314, at p.51.

997 For a complete historical background see Chapter 2, at pp.16ff.

998 Emphasis added. FC/WP2(56)1, at p.2.

solution for this problem only, and not as a generic definition of residence[999]. Yet, while the purpose of the tie-breaker was to define residence at the treaty level, whether the so-called *limitations* to the internal concept of residence in Art.4(2) and (3) OECD MC are capable of setting out a distinct definition of residence, that is a sensibly different question.

The tie-breaker rule is in principle only meant to set out objective criteria capable of solving a very concrete problem: the need to choose between two nexus with two different States. This is done through a series of elements such as permanent home, centre of vital interest, habitual abode, place of effective management, amongst others, which are allegedly meant to clarify which of the two attachments is *stronger*[1000]*.* One may argue that if a person is liable to tax in two States, his tax liability will be stronger if it is based on having, for instance, a permanent home in one State, rather than simply having his centre of vital interests or his habitual abode therein.

Although this is the logic behind the Model, it is hard to see how it is that the criteria contained in the rule affects the *quality* of the nexus required for a claim to prevail. In other words, it does not seem that the tie-breaker is meant to re-define the kind of attachment a person must have to be considered as a resident under Art.4(1) OECD MC. It appears that the purpose of the rule is, more precisely, to manifest the need to ignore the rules of domestic law and to break the tie on the basis of international standards, providing enough certainty to the application of the Model.

Therefore, while there is no concrete definition of residence if one looks at the tie-breaker itself, the treaty definition of residence would arise whenever the factors that the OECD has considered to break ties are attributed their meaning at the treaty level and not at the domestic level. This idea is relevant if one considers the lack of clarity as to the source from where the terms contained in the tie-breaker need to be defined. There is no clarity as to whether expressions such as 'permanent home' need to be defined at the treaty level or, following the general rules laid down in Art.3(2) OECD MC, under domestic law, unless the context otherwise requires[1001].

As early as in 1981 Avery Jones justified the need to provide the terms in Art.4(2) and (3) OECD MC an international fiscal meaning, by explaining that the context obliges the interpreter to dismiss the domestic meaning of those expressions[1002]. In addition to the arguments presented by Avery Jones, it is clear that the rule of Art.4(2) and (3) OECD MC would be, more than properly re-qualifying the attachment which gives place to residence, imposing the need to look at the

---

[999] See Chapter 2, at pp.16ff. Cases of single residence were to be analysed solely on the basis of the provisions of domestic law: "The draft Article is intended *only* to solve the conflict between two domiciles" (emphasis added). Similar to the current version of the Commentaries, the old version declared the relevance of the concept of residence in three cases: a) in determining the scope of application of the convention; b) in solving dual residence conflicts and c) in solving conflicts between residence and source. The draft rule, under its original formulation, was expressly meant to deal only with the second objective, see FC(58)2(1st Revision) Part II, at p.16. This changed afterwards, when the OEEC modified the Commentaries to state that: "The Article is intended to define the meaning of the term "resident of a Contracting State" *and to solve cases of double residence*", see Sec.2 of Comm. to Art.4 OECD Model Convention (2014). In all other cases, as Vogel has explained, "if there is only one residence under the domestic law of one contracting State, then that residence is also the relevant treaty residence", see Vogel, supra note 6, n.99, at p.261.

[1000] FC/WP2(57)1, at p.5.

[1001] Art.3(2) OECD Model Convention (2014).

[1002] These reasons are: firstly, that at least one of these expressions is unlikely to have an internal fiscal meaning under one of the State's laws; secondly, that the expressions used in the OECD MC are presumably intended to be given the same meaning by the States using the Model; thirdly, that the States may have more than one definition for any of these terms under domestic law, and fourthly, that the Commentaries indicate that the expression must be given an international fiscal meaning, see Avery Jones et al., 'Dual Residence of Individuals: The Meaning of the Expressions in the OECD Model Convention – I', in 1 *British Tax Review* (1981), at pp.20-22.

problem of residence from an international point of view, and therefore setting out an exception to Art.3(2) OECD MC[1003].

In a way, if one defines these terms on the basis of domestic law, there would be no *treaty* definition of residence in Art.4(2) and (3) OECD MC, but only a second and even more complex redirection to factors which, from a domestic perspective, may be relevant to define residence as an attachment between a person and a State[1004]. On the contrary, the policy objective behind the tie-breaker is to set out rules according to which, regardless of the provisions of domestic law, one may be able to break a tie between States as indisputably as possible[1005]. In that sense, the need for the terms contained in Art.4(2) and (3) OECD MC to be defined not at the domestic level, but at the treaty level, is evident[1006].

The question of whether the tie-breaker contains a definition of residence is relevant from a policy point of view, because it allows the interpreter to conclude that the expressions contained in the tie-breaker demand the adoption of international standards to break the residence tie[1007]. Only in that manner can it be properly said that the rules of the tie-breaker, and thus the OECD MC, contain a definition of residence which is different from the domestic one under the provisions of paragraph 1 of Art.4 OECD MC[1008].

12.2.3. Solution for dual residence: The preference criterion

The OECD historically chose the path of breaking a tie between States by giving *preference* to one claim over the other:

> "At a clash of the internal concepts of domicile of several states there is a conflict of interests which, in the events here discussed, must, and only can, be solved by agreement on the application of a preference criterion laying down which of the two countries is to take priority with respect to their claims for tax [...]"[1009]

The current Commentaries to Art.4 OECD MC in fact add:

> "As far as possible, the preference criterion must be of such a nature that there can be no question but that the person concerned will satisfy it in one State only, and at the same time it must reflect such an attachment that it is felt to be natural that the right to tax devolves upon that particular State."[1010]

[1003] Makovníková mentions that Art.3(2) OECD MC was added to the Model only in 1963, while terms such as 'permanent home' had been used in the Model since the time of the League of Nations, in 1925, see Makovníková, Silvia, 'Permanent home as a tie-breaker criterion', in Hofstätter, Matthias, Plansky, Patrick (eds.), *Dual Residence in tax treaty law and EC law*, (Wien: Linde Verlag, 2009), at p.21.

[1004] "It would be senseless to rely on domestic law to resolve a conflict that arises by virtue of the application of domestic law", see Pittman, Shauna, 'The Centre of Vital Interests Rule: Do Personal Interests Prevail over Economic Interests?', in Hofstätter, Matthias, Plansky, Patrick (eds.), *Dual Residence in tax treaty law and EC law*, (Wien: Linde Verlag, 2009), at p.37.

[1005] Sec.10 of Comm. to Art.4 OECD Model Convention (2014). If one considers that these terms, being undefined at the treaty level, need to be defined according to the rules of domestic law, the possibilities of breaking the tie and thus the efficacy of the rules would be reduced significantly.

[1006] According to the Four Economists, "domicile or habitual residence must everywhere be interpreted alike for the purposes of taxation [...] so that there will be no possibility of misinterpretation", see LON, E.F.S.73.F.19, at p.25[4029].

[1007] Vogel, supra note 6, n.67, at p.246. Some authors in fact regret that there has not been an express exception to Art.3(2) OECD MC in Art.4 OECD MC, but they arrive to the same conclusion: Of all the elements in Art.4(2) and (3) OECD MC, nationality is the only one which, on a reasonable and purposeful interpretation of the Model, needs to be defined under internal legislation, see Avery Jones et al., supra note 1002, at pp.15-22.

[1008] The purpose of the tie-breaker is to supplement the definition of residence at the domestic level, see Vogel, supra note 6, n.68, at p.246.

[1009] Underlined text in original, see FC/WP2(56)1, at p.2.

While it is clear that the object of these rules is to give preference to one claim over the other, it is interesting to note that this is not the only solution the States have implemented to solve the dual residence conflict. In order to prevent the use of the Model for tax avoidance purposes, some States have replaced the preference criterion for a general rule denying treaty benefits in cases of dual residence[1011]. While this eliminates the root of the problem, namely the potential tax avoidance goal behind a residence tie, there are nonetheless *bona fide* situations of dual residence, that occur in the absence of any tax avoidance considerations[1012]. These cases are, however, left without the scope of the Model under the OECD's approach.

12.2.4. The effects of the tie-breaker on domestic law and other treaties: Residence as defined 'for the purposes of *this* Convention'[1013]

The OECD has stated that the purpose of the tie-breaker is to define residence in a way in which one tax claim is given preference over the other. The rule, however, has been attributed other significant effects. In 2008[1014] the OECD promoted an interpretation of the tie-breaker according to which its application affects the status of resident for the purposes of other treaties:

> "According to its wording and spirit the second sentence [of Art.4(1) OECD MC] also excludes from the definition of a resident of a Contracting State […] companies and other persons who are not subject to comprehensive liability to tax in a Contracting State because these persons, while being residents of that State under that State's tax law, are considered to be residents of another State pursuant to a treaty between these two States."[1015]

The issue is in fact problematic because there is no agreement in relation to the possibility of supporting this argument from the perspective of the Model itself. The Ministry of Finance and the Supreme Court of the Netherlands have employed this reasoning to deny treaty benefits in a variety of cases[1016], and prominent authors have supported this idea. Sasseville, for instance, has

---

[1010] Sec.10 of Comm. to Art.4 OECD Model Convention (2014). The origin of these Commentaries goes back to 1957, see FC/WP2(57)3, at p.7.

[1011] The denial of treaty benefits occurs directly in the presence of a dual residence situation, as in the case of Art.4(3) of the Australia – Chile tax treaty; or after the mutual agreement procedure has failed to break the tie, see for instance Art.4(3) of the Spain – Chile tax treaty, Art.4(3) of the Switzerland – Chile tax treaty, Art.4(3) of the Belgium – Chile tax treaty. As a matter of fact, the OECD seems to have moved in that direction when introducing changes to the tie-breaker for entities, as will be examined in a subsequent section. Under the updated version of the tie-breaker for entities, proposed in 2015, in the absence of agreement between the competent authorities of each State, the tie is not broken, and treaty benefits are not granted to the dual resident entity, see OECD, Public Discussion Draft, supra note 510, at p.5.

[1012] It must be borne in mind "that dual residence is a result of conflicting residency rules of two legislations and is not necessarily related to tax avoidance", see Gyöngyi Végh, supra note 447, at p.162.

[1013] This aspect of the definition, from an historical perspective, as been also touched upon in Chapter 2, at pp.20ff.

[1014] OECD, *The 2008 Update to the OECD Model Tax Convention*, (Paris: loose-leaf, 2008), at p.6.

[1015] Sec.8.2 of Comm. to Art.4 OECD Model Convention (2014). Under the updated Commentaries, '[t]he term "resident", as used in paragraph 3 and throughout the Convention, is defined in Article 4. Where, under paragraph 1 of Article 4, a person is considered to be a resident of both Contracting States based on the domestic laws of these States, paragraphs 2 and 3 of that Article determine a single State of residence for the purposes of the Convention. Thus, paragraph 3 does not apply to an individual or legal person who is a resident of one of the Contracting States under the laws of that State but who, for the purposes of the Convention, is deemed to be a resident only of the other Contracting State", see OECD, Action 6: 2015 Final Report, supra note 1, at p.88.

[1016] The issue was put forward by The Netherlands Ministry of Finance, and the Hoge Raad of the Netherlands upheld the OECD's reasoning in its ruling of 28 February 2001, No.35.557, BNB 2001/295. This has been commented by van Raad, supra note 57, at pp.27-29; Vogel, Klaus, 'Tax Treaty News', in 56 *Bulletin for International Taxation* 1 (2002), at p.2; Betten, supra note 57; Smit, supra note 57, at pp.155-158; Damen, supra note 120, at pp.290-292. It is interesting to highlight that in 1999, at an IFA Seminar in London, there was agreement on the fact that this interpretation was "generally thought to be wrong", see Avery Jones et al., supra note 417, at p.19.

stated that '[u]nlike the first sentence [of Art.4(1) OECD MC], the second sentence does not provide that the relevant liability to tax is that which arises "under the laws of that State." [...] The wording of the last sentence read in the context of the treaty and in accordance with the overall purpose of the treaty, would therefore appear to allow a country to take account of the effect of the provisions of its other treaties in determining whether an individual is liable to tax only on income from domestic sources.'[1017]

Van Raad, on the other hand, has sustained the contrary argument[1018]. In his opinion, the expression 'for the purposes of *this* Convention' in Art.4 OECD MC restricts the influence of the Model on the laws of the States and other tax treaties[1019]. A person who loses the tie by this reasoning would not cease to be considered as a resident of that State, because the term resident operates 'for the purposes of this Convention' *only*[1020]. In support of this approach, it is reasonable to observe that a State that gives up its authority to tax certain items of income obtained by specific taxpayers due to a treaty, does not necessarily renounce to treat such taxpayers as residents in relation to other flows of income, or during other taxable periods[1021].

Despite the fact that the OECD has promoted this new interpretation of the Model quite recently, this does not imply that the issue became relevant only in 2008. Whether the rule is apt to generate such a transcendent effect has been debated for decades. As early as in 1964, the Delegation for Japan raised this issue by sending some questions to the Fiscal Committee:

> '2. Suppose the case where a person who is a resident of both of the Contracting States A and B under respective domestic laws (hereinafter called "taxpayer") is deemed as a resident of State B for the purposes of the Tax Convention between State A and State B. How shall State A solve the following problems that may arise in the application of its domestic tax laws? Namely: [...]
>
> (2) Whether State A should treat "taxpayer" as a resident of State A for the purpose of its own taxation on condition that it grants him all the benefits for a resident of State B stipulated in the Convention, or State A should treat "taxpayer" wholly as a non-resident. If "taxpayer" should be treated as a non-resident, "taxpayer" might suffer from a disadvantage in a certain case because of the non-applicability of personal deductions or the application of flat tax rate. Should this disadvantage be considered as an inevitable consequence of the application of Article 4? Or is it necessary for State A to give him option to remain a resident of State A for the taxation purposes?'[1022]

The Delegation for Sweden upheld these concerns in 1967:

> "In paragraph 2 of Article 4 rules are given with the intention to solve cases of double residence of individuals. However, quite a few cases have occurred where a taxpayer, who according to Swedish law is clearly resident in Sweden, is considered, for the purposes of a tax convention with another contracting State, as a resident in that State. In these cases the result sometimes has turned out to be unsatisfactory from the Swedish point of view, especially with respect to recent legislative measures introduced in order to counteract tax evasion by means of a transfer of residence."[1023]

[1017] Sasseville, supra note 58, at pp.44.

[1018] Svobodová provides several consistent arguments to support van Raad's position, see Svobodová Jana, 'Treaty entitlement of dual residents', in Hofstätter, Matthias; Plansky, Patrick (eds.), *Dual Residence in tax treaty law and EC law*, (Wien: Linde Verlag, 2009), at pp.111-113.

[1019] See van Raad, supra note 32, at p.242; van Raad, supra note 57, at p.29; van Raad, supra note 55, at pp.187-190. The history of the phrase 'for the purposes of this Convention' is explained in detail in Chapter 2, at pp.20ff.

[1020] Vogel, supra note 6, n.98, at p.260-261.

[1021] Svobodová, supra note 1018, at p.113.

[1022] TFD/FC/173, at p.2.

[1023] TFD/FC/216, at p.27. The observation was attached to Art.23 on the methods of relief, because Sweden had dealt with this issue by introducing a special rule in its tax treaty with Switzerland reserving "the right to tax an individual who according to Swedish legislation is resident in Sweden but who according to the Convention is resident in the other contracting State". Switzerland, its treaty partner, introduced an observation to Art.27 on diplomatic

Having considered the issue, in 1975 the OECD observed:

> '5. Each of two Contracting States may subject, under its internal law, the same person to unlimited tax liability, either as a resident of such State, or exceptionally as a national thereof. The Draft Convention aims at avoiding the situation that such person continues to be subjected in both States to tax in his total worldwide income and capital: Under Article 4 of the Convention the person will be considered, for the application of the Convention as a resident of State A only. The intention is that the other Contracting State B should be precluded from taxing income or capital for which the Convention gives the right to tax to the State of residence […].
>
> 6. One solution would be to state in Article 23 or 23A or 23B quite generally that the income derived or capital owned by a resident of a Contracting State shall be exempt from tax in the other Contracting State, except where another Article of the Convention expressly provides for taxation of such capital or income in the State which is not the State of residence. *The same goal could be achieved by inserting in paragraph 1 of Article 4 after "For the purposes of this Convention" the words: "and the internal law of the Contracting States".*'[1024]

The OECD's position raises many questions in relation to the link between the 2008 interpretation of the rule and the concerns which gave place to the addition of a second sentence to Art.4(1) OECD MC[1025]. Regardless of these questions, it is more or less clear that such an effect cannot be effortlessly attributed to the tie-breaker as such[1026], which is in line with van Raad's thoughts. On the contrary, an express compromise between the States to apply these rules in such a manner is necessary or, in the absence of that, a provision denying the status of resident as an effect of applying tax treaties at the domestic level.

---

privileges, stating the need of such rules in the text of the Model. Notwithstanding the clear opportunity to notice the connection between these two issues, no comments were raised in relation to that, see TFD/FC/216, at p.33.

[1024] CFA/WP1(75)5, at pp.2-3.

[1025] Chapter 7 contains a detailed analysis of the second sentence of Art.4(1) OECD MC, in the context of which it is explained that the addition of this interpretation in 2008 does not find support in the concerns which gave place to the inclusion of the second sentence in 1976. As a matter of fact, both the issue of residence of diplomats and the concerns expressed by the Japanese and Swedish Delegations were in charge of the same working group, and they were nonetheless never mixed up. The records of those sessions were in fact titled: "Working Party No. 28 of the Fiscal Committee. Second report on articles 1, 4, 14 to 20 and 21, and questions concerning annuities and residence of diplomats", see FC/WP28(68)2, at p.1. The OECD, however, 44 years later, surprisingly decided to promote this interpretation and to attach such a transcendent effect to the tie-breaker; see Chapter 7, at pp.84ff.

[1026] It is interesting to observe that by 1999, at an IFA Seminar in London there was agreement on the fact that not even the Commentaries to the Model were able to support this interpretation of Art.4 OECD MC, which was in fact "generally thought to be wrong". Avery Jones and Bobbett summarised the conclusions arrived at by Seminar E at the IFA Congress in London, in relation to triangular treaty problems, and they analysed the position of the Netherlands Ministry of Finance in relation to the tie-breaker in order to reach these conclusions. See Avery Jones et al., supra note 417, at p.19. The problems in connection with the mismatch between the treaty and the domestic definition of residence when solving the dual residence conflict have also been underpinned in the field of BEPS, see OECD, Public Discussion Draft, supra note 510, at pp.5-6. From the words of Dirkis, it is interesting to notice how a country like Australia, despite recognising the merits of this approach, has not been fully convinced of applying it, see Dirkis, in relation to corporate residence, supra note 83, at pp.337-338. Austria is another example where the prevailing opinion is that a tie-breaker loser fulfils the criteria of domestic residence and thus for the purposes of treaties, see Simader, supra note 118, at pp.371-372. The same applies in Belgium, see Bammens, supra note 303, at pp.401-402; Germany, see Englisch, supra note 102, at p.504 and at p.515, and Rust, supra note 216, at pp.390-391; Italy, see Dorigo, Stefano, 'Italy' (Country Reports), in Maisto, G., (ed.), *Residence of Individuals under Tax Treaties and EC Law*, (Amsterdam: IBFD, 2010), at p.427; the Netherlands, at least domestically, see de Boer, supra note 141, at p.595, and Gunn, supra note 245, at p.493; South Africa, until finally its laws were amended in 2003, see Hattingh, supra note 235, at p.751; Spain, see Martinez, supra note 235, at p.791, and Nuñez, supra note 240, at p.532; Switzerland, see Maraia, supra note 223, at p.811; and the United States, see Brauner, supra note 111, at p.883.

Some States have in fact opted for treating tie-breaker losers as non-residents[1027]. However, in those cases the fact that the person is denied the resident status does not result from the provisions of the Model, but as a consequence of the laws of that State. After all, a person needs to be a resident "under the laws" of a State to claim treaty benefits. In the absence of an express agreement, that question is finally to be answered on the basis of those laws.

It is evident that the interpretation promoted by the OECD in 2008 had an anti-avoidance purpose[1028], but the manner in which the idea has been proposed does not seem to converge with the rest of the rules of the Model. A person who loses a tie-breaker, in synthesis, needs to be treated as a non-resident for the purposes of domestic law and other treaties because, as a result of the tie-breaker, that person would not be subject to the 'most comprehensive' tax liability imposed by a State.

The consequences of following this line of reasoning have been largely explained in relation to conduit companies[1029]. In the case of the tie-breaker, it may be relevant to reiterate and emphasise that, unless the laws of a State treat a person as a non-resident after losing a tie-breaker, to speak of 'limited tax liability' is erroneous (insofar as the person will remain subject to that State's tax authority[1030]). Although it is evident that the dual residence conflict may be used to abuse tax treaties, this anti-abuse approach is misleading, because it is limited by the Model's incapacity to modify, on its own merits, the provisions of domestic law dealing with residence[1031].

12.3. Tie-breaker for individuals in Art.4(2) OECD MC

12.3.1. Introduction: Breaking the tie through a hierarchy of tests

The need to break the tie and, more precisely, the election of the appropriate criteria to do so in the case of individuals, has been largely discussed by the OECD. By 1956, Working Party 2 had a broad notion of the tests needed to break ties:

> "By way of example the following factors may be mentioned, *the order being of no consequence to the weight that should be attached to the factor* in question:
> (1) available residence,
> (2) residence of wife and children,
> (3) relatives,
> (4) duration, regularity and frequency of residence in the various states,
> (5) in the service of one state and residence in another,
> (6) citizenship,
> (7) social attachment,
> (8) capital investment,
> (9) earnings.

[1027] Only the States in which the domestic laws have been modified are able to exclude dual resident losers from domestic and thus treaty residence, see Canada in Brooks, supra note 127, at pp.438-439; and the United Kingdom, see Hji Panayi, supra note 126, at p.883. This is also the case of France, see Delattre, supra note 125, at p.203; the United Kingdom, see FA 1994 Section 249(1); and Canada, see Income Tax Act, section 250(5).

[1028] Van Raad in fact proposes that the addition may have been made to avoid access to the treaty networks of both States, see van Raad, supra note 55, at p.188. See also Boccardo, supra note 427, at p.129.

[1029] See Chapter 7, at pp.84ff; and in relation to the particular issue of abuse, see Chapter 10, at pp.156.

[1030] According to Sasseville "Paragraphs 2 and 3, however, only have effect for the purposes of the treaty. They do not affect the domestic-law status of the resident", see Sasseville, supra note 58, at p.45.

[1031] Moreover, this approach has another undesirable and inevitable effect, which is the exclusion of residents of States applying a territorial system of taxation, see Chapter 7, at pp.91ff.

> The determination should thereupon rest on the weighing and testing of the said, and possibly other, factors and their mutual importance; a determination which, if occasion should arise, may be difficult, indeed impossible."[1032]

While due consideration was given to the possibility of applying the diverse tests conjunctively, and regardless of the undeniable advantages this option presents in terms of quality of the argument, the OECD opted for establishing a hierarchy of tests, to be applied one by one, in isolation. One cannot simply advance in the chain if a certain test does not serve to break ties[1033]. The Model itself explains the mechanism for their application.

The Model also deals with the meaning of the expressions contained in it. As was stated earlier in this section, the spirit of the Model and the policy objective behind the rule of Art.4(2) OECD MC is to establish a treaty definition of residence. For that to occur the terms used to break ties must be provided an international fiscal meaning. In that context, the Commentaries to the Model provide several elements to attribute their meaning to these terms, which are examined in the following lines.

12.3.2. The tie-breakers: Brief history and definition

12.3.2.1. Permanent home[1034]

In the first place in the hierarchy, Art.4(2)(a) OECD MC considers the "place where the individual owns or possesses a home"[1035]. In 1957, Working Party 2 defined 'permanent home' as follows:

> "In the case of a physical person, to the country in which he has his permanent home, that is to say, the centre of his vital interests, or, in other words, the place with which his personal ties are closest."[1036]

Historically, the term 'permanent home' was defined by reference to the personal connections an individual had in a certain State. Accordingly, a German proposal referred to the term as "permanent dwelling"[1037], while France understood the criterion to signify "the place where an individual lives with his family"[1038]. This conception of the term, however, changed with the passage of time. At a certain point and probably motivated by the Delegation for Switzerland[1039], in its Fourth Report Working Party 2 mentioned the tests separately[1040].

By 1972 it was clear in the Commentaries that the meaning of 'permanent home' was limited to a physical place, that is, a physical construction where a person could spend time, like a house or an apartment, located in one of the Contracting States. Instead of referring to his personal relations, the term was restricted to the existence and availability of a house or other similar installation,

---

[1032] FC/WP2(56)1, at p.3.
[1033] Italy, Corte di Cassazione, 4 April 2000, *Case 4112*, IBFD case law.
[1034] See also the detailed analysis of the term by Makovníková, supra note 1003.
[1035] Sec.12 of Comm. to Art.4 OECD Model Convention (2014).
[1036] FC/WP2(57)1, at p.2 and at p.6.
[1037] TFD/FC/17, at p.1.
[1038] TFD/FC/216, at p.5.
[1039] The Delegation for Switzerland highlighted this in 1957: "The practice is generally to refer to the circumstances of having a permanent home available in a State. But, as this criterion is not always identical with that of the centre of vital interests, the latter should also be mentioned", see FC/WP2(57)2, at p.6. A proposal by the Delegation for Germany moreover referred to "permanent dwelling" and then, as a separate test, to the "centre of vital interests", see TFD/FC/17, at p.1.
[1040] FC/WP2(57)3, at p.2.

defined as 'home'[1041]. Instead of defining the place through the existence of personal relations, it was the existence of the place itself which gave notice of those ties[1042].

Under the current Commentaries, such a home has been defined in very broad terms. It may take a number of forms, from a house or apartment belonging to or rented by the individual, for instance, to a rented furnished room[1043]. According to this broad concept, even a furnished room in a residence of a family member, or a home owned by a corporation of which the taxpayer is a shareholder may qualify as a 'permanent home'[1044]. What really matters is not the kind of home, but rather that the individual "must have arranged and retained it for his permanent use as opposed to staying at a particular place under such conditions that it is evident that the stay is intended to be of short duration"[1045]. The expression 'permanent', in other words, is meant to portray the fact "that the individual has arranged to have the dwelling available to him at all times continuously, and not occasionally for the purpose of a stay which […] is necessarily of short duration"[1046]. The temporal dimension of the term, that is, the fact that such home needs to be 'permanent', excludes cases of use for limited periods[1047]. Further, the fact that the home needs to be 'available' means that the person must reserve the ability to use that place[1048] regardless of any legal title[1049], whenever he decides.

To sum up, the criteria contained in the 'permanent home' definition aims to identify a location where it is likely that the individual will spend time because of having a dwelling, a place, or a facility available to him to do so. Considering that the OECD made an express decision to exclude personal aspects from the 'permanent home' test and to create a separate rule to take them into consideration, it is fair to conclude that one does not need to demonstrate the presence of actual personal or economic ties with the State in which this home is possessed[1050]. On the contrary, to overcome the test, all an individual needs to do is to provide evidence that there is a location which, in a continuous manner, is available to him to spend as much time as he desires, even if this

---

[1041] See CFA(71)10(Corrigendum), at p.3. This coincides with the current drafting of the Commentaries, see Sec.13 of Comm. to Art.4 OECD Model Convention (2014).

[1042] Makovníková observes that the consideration to personal attributes in the 'permanent home' criterion generates an overlap that is not harmful between this concept and the 'centre of vital interests' criterion, see Makovníková, supra note 1003, at p.28. This, however, does not coincide with the policy objective pursued by the OECD when differentiating between these two concepts, as illustrated by the history of the Model.

[1043] Sec.13 of Comm. to Art.4 OECD Model Convention (2014). The Netherlands Supreme Court ruled that a hotel room could constitute a permanent home, see The Netherlands *Hoge Raad*, 21 February 1973, BNB 1973/96.

[1044] Makovníková, supra note 1003, at p.31. The notion, however, is not without limits. The lack of a lease agreement or the failure to demonstrate the payment of rent may render the argument of the establishment of residence meaningless, see Canada, Tax Court, 8 April 2005, *Allchin v. Her Majesty the Queen*, 2005 TCC 476, at para.43.

[1045] Sec.12 of Comm. to Art.4 OECD Model Convention (2014). This is mainly the reason why holiday homes are often rejected as apt to constitute residence for treaty purposes, despite the fact that the answer to the question of whether these homes can be regarded as permanent homes must be observed on a case-by-case basis, see Makovníková, supra note 1003, at pp.23-24.

[1046] Sec.13 of Comm. to Art.4 OECD Model Convention (2014).

[1047] Vogel, supra note 6, n.71, at p.247.

[1048] Makovníková uses some interesting examples to illustrate the concept of availability. By way of illustration, the fact that a person may sublet his place to somebody else presents evidence of the place not being 'available' to him *at all times*, see Makovníková supra note 1003, at pp.32-33.

[1049] To Vogel, "actual power of disposition […] encompasses both the right which the master of a house has and the right of its owner or tenant to determine occupancy of the dwelling", see Vogel, supra note 6, n.71a, at p.248.

[1050] According to Vogel, it is the personal link with the accommodation that demonstrates how intense is the connection with any of the contracting States, see Vogel, supra note 6, n.70, at p.247. Further, Arnold has commented some New Zealand case law where the court defined the 'permanent home' broadly, in relation to the taxpayer's personal relations, see Arnold, Brian, 'Tax Treaty News', in 66 *Bulletin for International Taxation* 9 (2012), at p.481.

never actually happens[1051]. In other words, it is the existence of a home that gives notice of a person's ties, and not the other way around.

12.3.2.2. Centre of vital interests

As was mentioned before, the history of the Model suggests that, for years, permanent home and centre of vital interests were one and a single test. Under one of the first versions of Art.4 OECD MC, the tie-breaker for individuals established:

> "Where a person is fully liable to taxation in more than one Member country, the right to tax shall belong:
>
> (1) in the case of a physical person, to the country in which he has his permanent home, that is to say, the centre o his vital interests, or, in other words, the place with which his personal ties are closest."[1052]

When the OECD established the need to look at those ties through a separate test, the question immediately arose as to the nature of the relation to be portrayed by them. In particular, the Delegation for Germany introduced the question of whether the economic dimension of the link needed to be considered[1053]. Working Party 2, however, was not of that opinion:

> "As will be seen, *only the taxpayer's personal attachment is taken into consideration, whereas the economic one is disregarded*. If the attachment is mainly an economic one, it will be natural for the country concerned to make good its claim to tax by means of a tax at the source, which is also gradually becoming common practice."[1054]

The early history of the test is clear in terms of excluding any consideration to the economic dimension of the person:

> "The proposals made, which attach decisive importance only to the personal relations, appear to the Working Party to provide the clearest solution. A criterion which has to take both personal and economic relations into consideration is more difficult to handle, because the personal relations may be found to be as strong with the one State as the economic relations are with the other [...]. It may further be stated that *it seems natural to leave out economic interests here, as one ought not really to attach any great importance to these considerations for the solution of the double domicile conflict*, the State in which an individual predominantly has economic interests being able to tax at the source the incomes derived from it."[1055]

It is interesting to highlight that the economic dimension of the individual was not to be considered when attributing its meaning to the term 'centre of vital interests' because, as will be explained below, according to the OECD taxation on the basis of an economic nexus was predominantly *source* taxation[1056]. In that context, a person's economic activities needed to be ignored when breaking a tie between two claims of residence. The obvious difficulties derived

---

[1051] It is interesting to notice that courts have ruled the presence of a permanent home in cases in which the relevant taxpayer has abandoned the State, if he has retained his home and the possibility exists for him to come back to it, even only to visit. After examining such case law, Makovníková observes that "the length of the individual's stay in a house or regular use of the house should not be given too much weight in determining the permanency. It might be argued that it is not the use which must be permanent, only the availability", see Makovníková, supra note 1003, at pp.22-23. Moreover, she concludes that the intentions of the taxpayer towards this home should also not be taken into consideration, see Makovníková, supra note 1003, at pp.26-27. Arnold has commented the *Trieste* case in Canada, where the 'permanent home' criterion was fulfilled because the taxpayer retained his home in Canada and visited only once a month, see Arnold, Brian, 'Tax Treaty News', in 67 *Bulletin for International Taxation* 3 (2013).

[1052] FC/WP2(57)1, at p.2.

[1053] A proposal by the Delegate for Germany referred to "permanent dwelling" and then, as a separate test, to the "centre of vital interests", see TFD/FC/17, at p.1.

[1054] Emphasis added, see FC/WP2(57)1, at p.6.

[1055] FC/WP2(57)3, at p.8.

[1056] This idea is examined in detail some paragraphs below, at pp.199.

from having personal and economic relations with different States[1057] finally tipped the balance towards fully disregarding the latter.

The discussion, however, did not end there. The need to consider the economic dimension of the person was further analysed[1058] and, despite the OECD's initial unwillingness, in 1958 the Commentaries were changed to include these economic activities as part of the term "personal relations"[1059]. At the outset, the expression "economic relations" was added to the Model itself some months later[1060].

Under the current Art.4(2)(a) OECD MC the 'centre of vital interests' test is essentially different from the 'permanent home' test, and considers the personal and economic relations of the individual:

> "If [the individual] has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests)."[1061]

One cannot but observe that the test needs to be applied exclusively if the relevant taxpayer is found to have a 'permanent home' in both contracting States[1062]. If this were not the case, the place of 'habitual abode' needs to be ascertained[1063]. Bearing in mind that this test aims to determine the State with which the individual who possesses a permanent home in both States has closer personal and economic relations, the Commentaries further clarify:

> "[…] regard will be had to his family and social relations, his occupations, his political, cultural or other activities, his place of business, the place from which he administers his property, etc. The *circumstances must be examined as a whole*, but it is nevertheless obvious that considerations based on the *personal acts of the individual must receive special attention*. If a person who has a home in one State sets up a second in the other State while retaining the first, the fact that he retains the first in the environment where he has always lived, where he has worked, and where he has his family and possessions, can, together with other elements, go to demonstrate that he has retained his centre of vital interests in that State."[1064]

The personal dimension involved in the 'centre of vital interests' encompasses "a taxpayer's entire way of life"[1065]. However, the opinion of the taxpayer in order to explain his relation with a given

---

[1057] Raised by the Delegation for France: 'Now the case where a person has his "persona relations" in one State and his "economic relations" in another State is very frequent and is likely to happen more and more often. It therefore seems to the French Delegation that to unite these two categories of "relations" to determine the centre of vital interests will not prove to be quite adequate but it has not for the moment found any satisfactory solution that it can propose for the attention of the Fiscal Committee", see TFD/FC/216, at pp.5-6.

[1058] DAF/FC/71.5, at p.3.

[1059] They "covered both family and economic connections", see FC/M(58)I, at p.3. This was finally added to the Commentaries in 1958, see FC(58)2(1st Revision) Part II, at p.18.

[1060] 'The Committee adopted the text of the draft Article on fiscal domicile […] with the following amendments: in paragraph II-1, add in the first subparagraph the words "and economic" after the word "personal" (with a corresponding amendment in the Commentary)', see FC/M(58)2, at p.5.

[1061] Art.4(3)(a) OECD MC, and Sec.14 of Comm. to Art.4 OECD Model Convention (2014).

[1062] When taking care of some observations by the United States Delegation in relation to the taxation of estates and inheritances, Working Party 17 stated: "It is, in fact, inconceivable that a deceased could have his centre of vital interests in a State […] without having there a permanent home, this being represented by any form of dwelling that was continuously available to him", see TFS/FC/178, at p.3.

[1063] The UK Delegation raised the question as to the appropriateness of this logic in 1967, see TFD/FC/216, at p.5.

[1064] Emphasis added. Sec.15 of Comm. to Art.4 OECD Model Convention (2014).

[1065] Vogel, supra note 6, n.74, at p.249.

place is irrelevant[1066]. On the contrary, if any consideration is given to his intentions, they must be considered objectively[1067].

Given the literality and the history of the Commentaries, regardless of the intention of the OECD, it is clear that an interpretation of the 'centre of vital interests' test in a way in which the personal activities of the taxpayer are preferred over his economic ones seems inevitable. Although the circumstances of the taxpayer need to be examined as a whole[1068], policy considerations inherent to the tie-breaker and to the definition of residence indicate that the personal aspects of the definition are preponderant[1069]. The economic dimension of the person is, under the OECD's approach, more likely to be covered by the consideration to source taxation, as will be emphasised in section 12.3.3 below, and it is not necessarily relevant for the purposes of breaking the residence tie.

12.3.2.3. Habitual abode

According to the history of the Model:

> "If the country in which [the individual] has his permanent home cannot be determined [...] the right to tax shall belong to the country in which he principally resides."[1070]

Often referred to as 'length of stay'[1071], 'principal abode'[1072], or 'continuing abode'[1073], the term 'habitual abode' was used in the context of the Model for the first time in 1958[1074]. Under the rules of the OECD MC, if the individual possesses a permanent home in both contracting States and it is impossible to determine in which one his centre of vital interests is located, or if the individual possesses a home in neither contracting State, Art.4(2)(b) OECD MC breaks the tie by reference to the State in which the individual has a 'habitual abode'[1075].

According to the Commentaries, if that were the case this "tips the balance towards the State where he stays more frequently. For this purpose, regard must be had to stays made by the individual not only at the permanent home in the State in question but also at any other place in the same State"[1076]. The same applies to individuals who do not have a permanent home in any of the States: "In that case also all stays made in a State must be considered without it being necessary to ascertain the reasons for them."[1077]

[1066] Although Schwartz has stated that an election by the taxpayer is "likely to be no less arbitrary than where the competent authorities decide", see the comments by Schwartz in Avery Jones et al., supra note 86, at p.664.
[1067] The Netherlands *Hoge Raad*, case number 24.142, BNB 1990/101.
[1068] Some courts have grounded entire rulings on possession of assets, for instance, see Rotondaro, supra note 963, at pp.387-388. According to Pittman, this statement would allow the conclusion that one needs to define whether, for a certain individual, personal or economic activities are more important, see Pitman, supra note 1004, at pp.46-47.
[1069] Some courts have been obedient in following these guidelines. Avella, for instance, analyses some EU case law to demonstrate how courts prefer personal over economic interests when defining the term, see Avella, Francesco, 'Using EU Law To Interpret Undefined Tax Treaty Terms: Article 31(3)(C) Of The Vienna Convention Of The Law Of Treaties And Article 3(2) Of The OECD Model Convention', 4 *World Tax Journal* 2 (2012), at p.121. Arnold carries out a similar analysis in relation to some New Zealand rulings, see Arnold, Brian, 'Tax Treaty News', in 66 *Bulletin for International Taxation* 9 (2012), at p.481.
[1070] FC/WP2(57)1, at p.2.
[1071] FC/WP2(57)1, at p.6.
[1072] Delegation for Switzerland, FC/WP2(57)2, at p.6.
[1073] FC/WP2(57)3, at p.2.
[1074] FC/M(58)I, at p.9.
[1075] Sec.16 of Comm. to Art.4 OECD Model Convention (2014).
[1076] Sec.17 of Comm. to Art.4 OECD Model Convention (2014).
[1077] Sec.18 of Comm. to Art.4 OECD Model Convention (2014).

The criterion involved in the habitual abode test is essentially temporal[1078], as it implies a comparison between the stays in both States claiming the right to tax on the basis of residence. Yet this does not mean that the stay itself can be temporary. On the contrary, the word 'habitual' indicates the need of regularity or frequency in relation to the stays in one State[1079]. Moreover, the length of the stay is not in itself relevant because the Model "does not specify over what length of time the comparison must be made. The comparison must cover a sufficient length of time for it to be possible to determine whether the residence in each of the two States is habitual and to determine also the intervals at which the stays take place."[1080] The comparison the test implies is, in fact, not even limited to the same taxable year[1081].

It appears that this temporal criterion is not restricted to one in which days must simply be counted but it seems to refer, more broadly speaking, to the place in which a person normally lives[1082]. Bearing this in mind, some authors have argued that the comparison must be made by taking into consideration several elements, such as the *animus* of the taxpayer towards the place[1083]. This would imply that the temporal absences of the taxpayer would not be relevant if he retains the intention to come back to this place, where his normal life is carried out. Such a conception of the 'habitual abode' test, however, would clearly generate an overlap with the centre of vital interests[1084], which does not seem to be the intention of the OECD when establishing separate tests to measure different kinds of connection with a given State. The purpose of the habitual abode test, considering its history, is to only decide which of the States in which a personal and economic connection cannot be clearly defined has the right to tax, on the basis of where the taxpayer stays more frequently. This cannot possibly mean that beyond the length and frequency of the stays any personal attachment with the relevant State must be demonstrated in order to comply with the test[1085].

12.3.2.4. Nationality

[1078] For a detailed explanation of the scope of the term 'habitual abode' see Barrera Vasquez, Marco Antonio, 'The limits of habitual abode and nationality tie-breaker rules in the OECD Model Convention', in Hofstätter, Matthias, Plansky, Patrick (eds.), *Dual Residence in tax treaty law and EC law*, (Wien: Linde Verlag, 2009), at pp.65-72.

[1079] Barrera Vasquez, supra note 1078, at p.67.

[1080] Sec.19 of Comm. to Art.4 OECD Model Convention (2014). This was a decision, see CFA(71)10(Corrigendum), at p.5.

[1081] Arnold, supra note 1069, at p.481.

[1082] Vogel, supra note 6, at p.253; Avery Jones et al., 'Dual Residence of Individuals: The Meaning of the Expressions in the OECD Model Convention – II', in 1 *British Tax Review* (1981), at p.116. See also Tax Court of Canada, *Allchin v. R*, 2 CTC, 2701, [2008], commented in Stacey, M., 'Habitual abode in Tax Treaties', 13 *Canadian Tax Highlights* 7 (2005), at pp.4-5; Canada, Tax Court, 29 September 2009, *Lingle v. R.*, 2009 TCC 435, in particular at para.28-30, commented in Arnold, supra note 1069, at pp.373-374. It appears, however, that most courts only count days: "During 1990, petitioner spent only 120 days in Montreal; he spent the remainder of the year in the United States, including 160 days in Florida and 50 days in South Carolina. Because petitioner spent more time in the United States […] it appears that petitioner had a habitual abode in the United States", see United States, Tax Court, 18 November 1998, *Stephen Podd, et al. v. Commissioner*, TC Memo 1998-418 Stephen D. Podd, et al. In a Canadian case, evidence showed that the taxpayer "spent more time in Korea than in Canada in 2001. Therefore, her habitual abode was in Korea and not Canada", see Canada, Tax Court, 22 July 2005, *Yoon v. Her Majesty the Queen*, 2005 TCC 366, at para.41.

[1083] Vogel has in fact explained that the term is meant to complete the meaning of the 'centre of vital interests' test, in the sense of permitting the election of the place with which the taxpayer's ties are closest when the centre of vital interests is unclear, see Vogel, supra note 6, at p.252.

[1084] Pittman, supra note 1004, at p.54.

[1085] "This expression should be interpreted literally, i.e. where the individual lives the longest and why he stays there – holidays, professional or personal reasons – and where he stays – hotels, flats or houses – is irrelevant", see Nuñez, supra note 240, at p.532.

According to Art.4(2)(c) OECD MC, "if [the individual] has a habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national."[1086] The test of nationality only applies if the habitual abode fails to break the tie. While there is not much to say in relation to this test[1087], it may be relevant to emphasise that the conditions to become a national are essentially a domestic concern, and they cannot be appreciated from any other perspective than that of the constitutional laws of the alleged State of residence[1088].

12.3.2.5. Mutual agreement procedure

According to Art.4(2)(d) OECD MC, "if [the individual] is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement"[1089]. In this sense, it is relevant to highlight that the possibility of reaching an agreement as to how the tie needs to be broken is not precisely left to the judgment of the States. According to the rule they *shall* find a way of breaking the tie[1090], and thus permit the application of the Model.

12.3.3. Nature of the connection in the tie-breaker for individuals

The character and essence of the links that the Model define as relevant for the purposes of breaking the tie appear to be distant from the economic dimension of the person involved[1091]. In the case of a 'permanent home', there is little to verify beyond the existence of a *locus* that is apt for the individual to live, even if he has ceased to use it. Even in the case of the 'centre of vital interests', in which some sort of an economic component may actually be noticed, it is clear that such dimension is only secondary, compared with the personal aspects of the link a taxpayer must have with a State in order to break the tie. A similar observation can be made in relation to a person's 'habitual abode', which is no more than a temporal measure to determine in which State he spends more time. Whether this indicates with which State he has a stronger economic nexus, or where he produces most of his income, is a totally different question.

This, however, should not be striking, insofar as it is based on a fundamental and calculated policy decision made by the OECD when drafting Art.4 OECD MC:

> "When determining which state is to be given preference, importance may be attached to the facts indicating the state with which the person concerned has:
>
> (1) the stronger economic relations, or
> (2) the stronger economic and personal relations, or
> (3) the stronger personal relations.

[1086] Sec.20 of Comm. to Art.4 OECD Model Convention (2014).

[1087] See Barrera Vasquez, supra note 1078, at pp.74-77.

[1088] Vogel, supra note 6, n.81, at p.253. Avery Jones observes that, amongst the elements in Art.4(2) OECD MC, nationality is the only one which needs to be defined under domestic rules. Whether this equates to stating that nationality as a tie-breaker must be defined autonomously by the contracting States, that seems to be a different issue, see Avery Jones et al., supra note 1002, at p.19.

[1089] According to Art.25 OECD MC, see Sec.20 of Comm. to Art.4 OECD Model Convention (2014).

[1090] Vogel, has referred to this as an "obligation to reach agreement", see Vogel, supra note 6, n.82, at p.254.

[1091] Despite the fact that, to some, individuals would have the need of establishing "a real social and economic presence in a state in order to become residents", see Duff, supra note 157, at p.77. Maisto has explained that the election of the criteria for individuals 'was based on "fair", and traditionally recognised standards which rely on sound personal attachments of the individual to the state', Maisto, supra note 538, at p.47. It is interesting to consider the views of Sadiq when analysing "physical presence as opposed to economic activity", see Sadiq, supra note 162, at pp.184-186.

> Gradually, as the various states have embarked on taxation of income originating from sources in the state concerned and through such procedure tax on the basis of an economic attachment, it appears natural, as far as natural persons are concerned, *to leave possibility (1) out of consideration*, so that the choice will be between a consideration of the personal attachment of the taxpayer concerned alone or of his personal as well as his economic attachment."[1092]

Under the reasoning behind the tie-breaker, because *source* taxation is imposed on the basis of an effective economic presence (giving credit to the economic activities of the taxpayer), the system of residence must not and cannot follow the same line[1093]. Residence must be defined by considering the economic activities of the relevant taxpayer as little as possible. Yet, it is more or less evident that focusing only on personal aspects of the treaty claimant makes the test quite easy to manipulate from a treaty abuse point of view, which is a recurrent question nowadays. These concerns, however, are not new. They were raised by the United States Delegation, when discussing the application of Art.4 OECD MC in the field of estates and inheritances, as early as in 1965:

> 'If domicile is to serve as a basis for determining jurisdiction to impose estate and inheritance taxes, it is important that the tests which determine the state of domicile be realistic and meaningful and not subject to artificial manipulation by taxpayers to their own advantage. Article 4 falls short in this respect in giving an undeserved importance to the place where one has had a "permanent home available". This would invite a taxpayer whose "centre of vital interests" is in State A, a country with high death duties, to keep a "permanent home available" in State B, a country with low death duties. Even though the taxpayer spent most of his time in State A, so long as he was careful always to stay in hotels and furnished apartments in State A without having any "permanent home available" there, on his death his intangible personal property would be subjected only to the low death duties of State B. […]
>
> To avoid this result, Paragraph 2(a) should be deleted. Priority could then be given either to the "centre of vital interests" […] or to "habitual abode". As described in Paragraphs 20-22 of the Commentary, the concept of "habitual abode" is a realistic one which gives due recognition to all visits in a State, without regard to the reasons for such visits or the type of accommodations occupied by the decedent while he was visiting. However, *it would be consistent with the preference for home over economic ties which is reflected in the present draft to give priority to "habitual abode" rather than to the "centre of vital interests".*'[1094]

While the policy considerations at the heart of the tie-breaker for individuals may be questioned from a treaty abuse point of view, it should not be surprising to find oneself in situations in which the interpretation of the tie-breaker results in the facilitation of treaty abuse. After all, the economic dimensions of a person, amongst them, his economic activities, play only a secondary role, at best, when breaking the tie in cases of individuals[1095].

[1092] Emphasis added. FC/WP2(56)1, at p.4.

[1093] To some these changes represent "a step towards the source taxation principle", see Romano, Carlo, 'Italy. The Evolving Concept of "Place of Effective Management" as a Tie-Breaker Rule under the OECD Model Convention and Italian Law', in 41 *European Taxation* 9 (2001), at p.343.

[1094] Emphasis added. These draft rules represented the views of the United States Delegation in relation to taxes on estates and inheritances, see TFS/FC/178, Annex. Views of the United States Delegation on the Seventh and Eight Reports of Working Party Nº 17 on Taxes on Estates and Inheritances, at pp.8-9. Working Party 17 however dismissed these arguments: "It is, in fact, inconceivable that a deceased could have his centre of vital interests in a State […] without having there a permanent home, this being represented by any form of dwelling that was continuously available to him", see TFS/FC/178, at p.3.

[1095] Avery Jones seems to have recognised this when proposing the addition of a tie-breaker according to which residence of an individual is recognised to be in the State in which a greater amount of his income is located. This was supposed to operate as "a proxy for closer economic relations". The test, however, was only considered as an alternative to the permanent home, and a 183 nights in the relevant State test, see the comments of Avery Jones and his proposal for a new tie-breaker in round table, Avery Jones et al., supra note 86, at p.656. Schwartz, on the other hand, suggested that "the rule must give priority to the substance of residential connecting factors over formal elements", although it is not clear whether this actually happens, see Schwartz comments in Avery Jones et al., supra note 86, at p.659.

12.4. Tie-breaker for persons other than individuals in Art.4 (3) OECD MC

12.4.1. Introduction: The 2015 changes to the tie-breaker for entities

In 2015, some relevant changes were proposed to Art.4(3) OECD MC. While the old version of the rule breaks the entity residence tie by giving preference to the State in which the place of effective management is situated, the modified version operates on the basis of a different test. This new test takes into consideration multiple other dimensions of the existence of those entities.

Regardless of the fact that the new version of the tie-breaker will settle any ties occurring under the new version of the Model, it is a fact that, under multiple tax treaties currently in force, the place of effective management test still persists. An effort will therefore be made, in the following lines, to explore both the current version of the entity tie-breaker, using the place of effective management test, and the modified version of it, introducing a new entity tie-breaker.

12.4.2. The tie-breaker for entities before 2015: Place of effective management

12.4.2.1. History: The fragile background of the tie-breaker for entities[1096]

The idea that a dual residence conflict in the case of entities may be rare in practice is a very old one, and it can be traced back to the beginning of the discussions at the OEEC[1097]. This is perhaps the reason why the issue was never taken really seriously. As a matter of fact, if one examines the history of the dual residence test for entities, the process, which ended up in the inclusion of the place of effective management test to Art.4 OECD MC, is quite disgraceful.

In 1956, the essence of the issue was described by WP2:

> 'The fact that the London Draft Convention attaches importance to "the real centre of management" must presumably be seen as an expression of the view that the determination must be made on the basis of considerations of facts and not merely on the basis of a formal registration. The term "real centre of management" and similar terms suffer, however, from the defect that they are not exact and that the question may be raised whether the real management of a joint-stock company is the general meeting (i.e. shareholders), or the board of directors or the managers.'[1098]

In parallel to the work of WP2, WP5 was in charge of the rules on taxation of income and capital of shipping and air transport enterprises[1099]. In that context, it was concluded that some conventions assigned the right to tax to the State in which the company's place of management was situated, while others focused on the place of effective management, or on the place of fiscal domicile or 'residence'. However, WP5 had a clear opinion on which test was the most appropriate:

[1096] Sasseville and Vann have explored in detail other aspects of the history of the place of effective management test, see Sasseville, Jacques, 'The meaning of "place of effective management"', in Maisto, G., (ed.), *Residence of Companies under Tax Treaties and EC Law*, (Amsterdam: IBFD, 2009), at pp.287-301; and Vann, supra note 41, at pp.209-243.

[1097] FC/WP2(56)1, at p.4. This has been debated: "other than stated in the Commentary, it is not rare in practice for a company to be subject to tax as a resident in more than one State", see van Weeghel, Stef, 'Article 4(3) of the OECD Model Convention: An inconvenient truth', in Maisto, G., (ed.), *Residence of Companies under Tax Treaties and EC Law*, (Amsterdam: IBFD, 2009), at p.304. Under the Commentaries updated in 2015, the mention subsists, see OECD, Action 6: 2015 Final Report, supra note 1, at p.73.

[1098] FC/WP2(56)1, at p.5.

[1099] FC/WP5(56)1.

> '[…] both the "place of effective management" and "fiscal domicile" can equally be regarded as offering an acceptable solution. Nevertheless, it seems that the principle of reserving the power to tax shipping or air transport enterprises to the State in which the effective management is situated should be regarded as being the *safer, and simpler in application*. […] One might therefore envisage using this formula in preference to the other.'[1100].

Without wasting too much time, after only two months WP5 expressed that the main reason to opt for the 'place of effective management' was the uncertainty as to the definition of 'fiscal domicile', a term which was still being elaborated by WP2:

> 'Another reason why the Working Party would like to keep the rule of "effective management" is the present uncertainty about the rule of "fiscal domicile". We do not know yet if or when we can come to an agreement about "fiscal domicile". If the Committee prefers the rule of "fiscal domicile", the whole question about taxation of shipping, etc. must be postponed until a decision is made on the report of Working Party No.2'[1101]

It is curious, to say the least, to notice that the 'place of effective management' test was chosen by WP5 in relation to shipping and air transportation because of the primitive stage in which the debate in relation to 'fiscal domicile' was. This is so because afterwards, when the time came to select the criteria for breaking the tie in the case of entities, the fact that the 'place of effective management' was used for the purposes of Art.8 OECD MC was regarded as highly relevant by WP2 to make such a crucial election:

> 'While discussing this question of the formulation of the preference criterion in the case of corporations, the Working Party takes the opportunity of calling attention to the Report […] submitted by Working Party No.5 on the taxation of income and capital of shipping and air transport enterprises. […] In its former reports Working Party No.2 proposed to adopt as a preference criterion the term used in the Conventions concluded by the United Kingdom: "where its business is managed and controlled". As it has been stated that this term means the effective management of the enterprise, and as it must appear natural to use the same criterion in the two Articles, the Working Party now proposes the same formula in paragraph (2) as proposed in the Article on shipping and air transport enterprises.'[1102]

By November 1957 it was relatively clear that WP2 had chosen the 'place of effective management' test as a tie-breaker for entities, and so it appeared in the proposed draft article[1103]. According to the 2014 version of the Commentaries[1104]:

> "The formulation of the preference criterion in the case of persons other than individuals was considered in particular in connection with the taxation of income from shipping, inland waterways transport and air transport."[1105]

> 'As a result of these considerations, the "place of effective management" has been adopted as the preference criterion for persons other than individuals.'[1106]

It is interesting to notice that the Delegation for Greece carried out a strong defence of the principle of 'fiscal domicile' instead of the 'place of effective management' test in relation to

---

[1100] Emphasis added, FC/WP5(56)1, at pp.5-7. At a later stage the place of effective management was described also as "more consistent with the realistic character of taxing legislation", see FC/WP5(57)2, at p.14. In none of those opportunities were any reasons given to sustain the convenience of that test.

[1101] FC/M(56)2(Prov.), at p.10. This was a prevalent argument used by WP5 in front of the Fiscal Committee to choose the 'place of effective management' test, see FC/WP12(58)1, at p.3.

[1102] FC/WP2(57)3, at p.9.

[1103] FC/WP2(57)3, at p.2.

[1104] FC/WP2(57)3, at p.2.

[1105] Sec.23 of Comm. to Art.4 OECD Model Convention (2014). The first version of these Commentaries can be traced to 1958, see FC(58)2(1st Revision) Part II, at p.19.

[1106] These Commentaries disappeared as a consequence of the BEPS project, see OECD, Action 6: 2014 Deliverable, supra note 902, at p.80; and OECD, Action 6: 2015 Final Report, supra note 1, at p.72.

income from shipping and air transportation activities. When one reads the arguments presented to the Fiscal Committee, it appears that the objection really aimed to criticising the OECD for trying to favour the consolidation of New York and London as the main shipping centres at that time, by using the 'place of effective management' test in its model convention[1107]. In any case, considering the depth of the analysis behind the inclusion of the 'place of effective management' as a tie-breaker, the number of problems derived from its use should not be striking.

12.4.2.2. 'Place of effective management' under the OECD MC before the BEPS project

The Commentaries to Art.4(3) OECD MC before the changes proposed in 2015 in the context of the BEPS initiative define the 'place of effective management' in the following manner:

> "The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are *in substance* made. All relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time."[1108]

Considering the need to define the term at the treaty level[1109] the OECD provides some guidelines[1110]. Firstly, the definition refers to a 'place'. This means that a physical location from where management is exercised must be identified[1111]. Secondly, this place is relevant because in it, key management and commercial decisions are made[1112]. The crucial character of such decisions is determined by the fact that they are vital for the conduct of the entity's business *as a whole.* Thirdly, according to the concept, one needs to look at the place where these decisions are made *in substance*. This seems to suggest that it is not enough to ascertain the place where, for instance, the board of directors meet, but rather one needs to identify whether those decisions are actually made by that board, or by other person instead. Finally, according to the guidelines set out in the Commentaries, it is clear that even though a company may have multiple places of management, there will only be one place of *effective* management, meaning "realistic, positive management"[1113], at any one time.

This definition has been controversial. It was modified in 2000, when the OECD tried to explain the rules to identify this place in the Commentaries[1114], and then again only eight years later, in 2008, when those changes were reversed[1115].

[1107] See FC(58)4, at pp.2-3. Greece, in fact, introduced a reservation on Art.8 OECD MC, reserving its right to settle the question of income from shipping and air transportation activities through bilateral negotiations, see FC/M(58)4, at pp.4-5, and the acceptance of the Fiscal Committee of these observations in FC(58)5, at p.7. Under the current Commentaries, that reservation can no longer be found.

[1108] Emphasis added. Sec.24 of Comm. to Art.4 OECD Model Convention (2014).

[1109] In words of Sasseville: "I personally think that the treaty context requires a common interpretation of the concept", see Sasseville, supra note 1096, at p.299.

[1110] It has been suggested that these guidelines set out a concept which cannot be identified with the Anglo-American term 'central management and control', or with the continental European concept of 'place of management', see Burgstaller, Eva and Haslinger, Katharina, 'Place of Effective Management as a Tie-Breaker-Rule – Concept, Developments and Prospects', 32 *Intertax* 8/9 (2004), at p.386.

[1111] For some negative effects of focusing too much on the *place* see Vogel, Klaus, 'Tax Treaty News', in 53 *Bulletin for International Taxation* 3 (2005), at p.418.

[1112] According to Vogel, what is "decisive is the not the place where the management directives take effect but rather the place where they are given", Vogel, supra note 6, n.105, at p.262.

[1113] "The place of effective management is where the shots are called, to adopt a vivid transatlantic colloquialism", see Sec.7, para.2, United Kingdom, Special Commissioners, 14 March 1996, *Wensleydale's Settlement Trustees v. Inland Revenue Commissioners*, IBFD case law.

[1114] 2000 addition: "The place of effective management will ordinarily be the place where the most senior person or group of persons (for example a board of directors) makes its decisions, the place where the actions to be taken by

12.4.2.3. Difficulties with the term 'place of effective management'

At the origin of the Model, the basic tie-breaker problem in the case of entities was *incorporation vs. management*. The 'place of effective management' test was chosen in comparison to registration, which according to the OECD was too easy to manipulate[1116]. The idea behind the test was to attribute the right to tax on the basis of residence to that State in which the fundamental decisions related to the administration of an entity were *in substance* made.

If one looks closely at the rules of the Model, it is interesting to note that this is as far as the solutions contained in it go. In other words, the rules are restricted to solving the question of whether incorporation or management is a more convenient criterion for breaking ties in the case of entities. While one may understand, as the OECD does, that this election implies the triumph of *substance over form*[1117], it is relatively evident that the questions posed by the use of the place of effective management in this particular field are significantly more complex.

As early as in 1964, the Delegation for Japan noticed:

> 'If a Contracting State adopts the "place of effective management" criterion in its domestic law, and the other Contracting State adopts another criterion such as the place of incorporation, a company incorporated in that other Contracting State and effectively managed in the first-mentioned State, is deemed to be a resident of the first-mentioned State under the Draft Convention. In this connection, a company might try to move the place of effective management to a country where the tax burden on company's profits is comparatively small."[1118]

While the observations made by the Japanese Delegation put forward some clear profit shifting concerns, with the passage of time the problems derived from the use of the place of effective management test have become more and more complex.

One author who has fiercely criticised the use of this test as a tie-breaker is van Weeghel. As he has so neatly explained, the issue 'is not so much dual residence as a result of the application of a formal criterion in one State and a substantive criterion in another state [which can be solved

---

the entity as a whole are determined; however, no definitive rule can be given […]", see Sec.24 of Comm. to Art.4 OECD Model Convention (2000).

[1115] See OECD, *The 2008 Update to the OECD Model Tax Convention*, (Paris: loose-leaf, 2008), at p.7. Sasseville has explained that the OECD may have reversed these changes because of having gone too close to the Commonwealth's concept of "central management and control", see Sasseville, supra note 1096, at p.294. Avery Jones, however, argues that the difficulties related to the expression have a longer history, see Avery Jones, '2008 OECD Model: Place of Effective Management – What One Can Learn from the History' in 63 *Bulletin for International Taxation* 5 (2009), at pp.183-186. There were strong critics to this new test: "This test is so vague that it seems inevitable that it will be applied inconsistently by various countries, which is especially undesirable for a tie-breaker rule", see Arnold, Brian, 'The 2008 Update of the OECD Model: An Introduction', in 63 *Bulletin for International Taxation* 5 (2009), at p.178. See also the analysis of Plakhin, Yevheniy, 'The Place of Effective Management as a Tie-Breaker Criterion', in Hofstätter, Matthias, Plansky, Patrick (eds.), *Dual Residence in tax treaty law and EC law*, (Wien: Linde Verlag, 2009), at pp.86-92; and Boccardo, supra note 427, at pp.125-133.

[1116] "The Working Party considered that it was natural not to attach importance to a purely formal criterion like registration", see FC/WP2(57)1, at p.6; and Sec.27 of Comm. to Art.4 OECD Model Convention (2014).

[1117] 'Given that the "place of effective management" [issue] is one of substance over form, in theory, it should always produce results which reflect the true policy intention of the tie breaker rule', see OECD, *The impact of the communications revolution on the application of the "place of effective management" as a tie breaker rule. A discussion paper from the technical advisory group on monitoring the application of existing treaty norms for the taxation of business profits*, (Paris: loose-leaf, 2001), at p.8.

[1118] TFD/FC/173, at p.4. The Japanese Delegation probably observed what the Commentaries to Art.8 OECD MC prescribed at that time: 'The "place of effective management" of an enterprise carried on by a resident of a Contracting State might be in neither of the Contracting States', see TFD/FC/173, at p.5.

under the current rules of the Model], but the real issues in the modern world are the interpretation of the term "place of effective management" and the determination where the place of effective management is.'[1119] There are, in fact, several obstacles derived from the definition that are quite useful in a tax planning context which, at the same time, pose several difficulties for tax authorities around the globe to ascertain where this place actually is.

The first problem refers to the very definition of an entity. The work of the OECD in the field of hybrid mismatch arrangements has demonstrated that the disparities between the laws of the States and the rules of the Model create weaknesses in dealing with hybrid entities[1120]. Secondly, following the observations by van Weeghel, the OECD MC tends to look at entities in isolation, but this is a world of multinational companies[1121]. A group's administration, often commanded by a board, operates simultaneously, in several cases, with international subsidiaries that are tightly managed domestically. Further, a top holding company may perfectly well be managed by an international board, and not even from a physical place. In both cases, it is quite a challenge to determine who in fact manages the relevant entities. Thirdly, alternatives such as consolidation or joint administration make it really hard to ascertain the place where key management and commercial decisions are in substance made[1122] and, at the same time, they pose serious obstacles to identify which decisions are in fact *key* for a group's businesses as a whole[1123].

Moreover, from a tax treaty abuse point of view, there is the question of whether the test necessitates a minimum standard of relevant substance. The Commentaries state that the place of effective management seeks to identify the country in which key management and commercial decisions are in substance made. Yet it is more or less obvious that this so-called *substance* is not the same one that is relevant in the context of abuse, as a parameter for tax treaty entitlement.

Even if one assumes that the test is not a legal one but a factual one, it is a reality that an entity may be created or modified in order to manipulate it. Places of management have been changed to abuse tax treaties and thus the question of whether the test is formal or factual becomes irrelevant. The test has been incapable of keeping up with economic development, and its flaws are particularly evident if one looks at the issue from the perspective of the evolution of technology.

12.4.2.4. Places of management in the era of modern communications

According to van Weeghel, the presence of electronic commerce is not the ultimate reason why the place of effective management test has collapsed. Its failure is due to the combination of the globalisation of multinational enterprises, the mobility of business executives, the *fungibility* of the shareholder base, and the convergence of share trading platforms[1124]. Despite the undeniable truth behind these statements, additional difficulties for the use of the place of effective

[1119] See van Weeghel, supra note 1097, at p.304. Sasseville in fact observes that the key issue in relation to the term is to define to what kind of management it refers, see Sasseville, supra note 1096, at p.299.

[1120] The OECD has in fact accepted that, despite the changes to the tie-breaker for entities, some of these distortions will not be solved, see OECD, supra note 820, at p.137.

[1121] Van Weeghel, supra note 1097, at p.305.

[1122] Vogel also mentions company-interlinking contracts, control contracts, management contracts, business leasing contracts, takeover contracts, amongst others, see Vogel, supra note 6, n.108, at pp.263-264.

[1123] "One member considered that one should ignore the management of each office and look for the management of the company as a whole, but another pointed out that the Commentary does not say this", see Avery Jones, John, 'Place of Effective Management as a Residence Tie-Breaker' in 59 *Bulletin for International Taxation* 1 (2005), at p.23.

[1124] See van Weeghel, Stef, 'The Tie-Breaker Revisited: Towards a Formal Criterion?', in Hinnekens, L., and Hinnekens, P., (eds.), *A Vision of Taxes Within and Outside European Borders*, (The Hague: Kluwer Law International, 2008), at p.965.

management test as a tie-breaker derive from the current technological framework. The availability of means of communication has made the determination of this place even easier to manipulate, despite the efforts of tax authorities and courts. The OECD has recognised in the Commentaries to the Model these difficulties:

> "Some countries also consider that such a case-by-case approach is the best way to deal with the difficulties in determining the place of effective management of a legal person that may arise from the use of new communication technologies."[1125]

In February 2001, the OECD created the Technical Advisory Group on Monitoring the Application of Existing Treaty Norms for the Taxation of Business Profits (TAG Group). According to this Group's conclusions:

> "[…] the availability of advanced and evolving communications technology such as videoconferencing or electronic discussion group applications via the Internet means that it is no longer necessary for a group of persons to be physically located or meet in one place to hold discussions and make decisions. In a modern environment, application of the traditional approach can produce results which do not reflect the intention of the tie-breaker rule."[1126]

The proposals by the TAG Group tried to sustain the need to update the entities' tie-breaker test from a policy perspective[1127] in the following manner:

> "In order to achieve a tie-breaker rule that will produce a single territory result in all cases, the following options may be considered:
>
> A) Replace the place of effective management concept.
> B) Refine the place of effective management test.
> C) Establish a hierarchy of tests, as in the individual tie-breaker so that if one test does not provide an outcome, the next test will apply; or
> D) A combination of B and C above.
>
> Another alternative is to deny dual resident companies the benefits under the Convention. Although this option does not address the issue of residence-residence conflicts resulting in double taxation, it does act as a deterrent to treaty abuse by dual resident companies."[1128]

Amongst these proposals, it is interesting to highlight the one according to which the 'place of effective management' was actually replaced by the "place where economic nexus is strongest". The explanations given by the TAG Group in relation to this particular rule were:

> '59. The economic connection to a State may be characterised by the extent that land, labour, capital and enterprise (the factors of production) are used by the company in deriving its profits. Using those characteristics the tie-breaker would serve to determine to which State, the company has its *strongest ties* and to deem the company to be a resident solely of that State.
>
> 60. While on the surface it may appear that such an option is more aligned to source taxation rationale, it also may have some links to the underlying rationale for residence taxation. It could be argued that if the State provides certain facilities and infrastructure for its residents, those who benefit most from such facilities and infrastructure ought to contribute to the State via residence-based taxes. So if a company uses the legal infrastructure, consumes or uses the facilities etc in that State, there is a case that it ought to be treated as a

---

[1125] Sec.24.1 of Comm. to Art.4 OECD Model Convention (2014).

[1126] OECD, *The impact of the communications revolution*, supra note 1117, at p.8.

[1127] "In a modern environment, the application of the above factors may not result in a clear determination of which State should be given preference as the State of residence, or may result in an outcome which does not appear to accord with the policy intentions of the provision", see OECD, *The impact of the communications revolution*, supra note 1117, at p.8.

[1128] OECD, *The impact of the communications revolution*, supra note 1117, at p.10.

> resident. If it does so in more than one State, then a tie-breaker rule based on economic nexus would require a determination (as with individuals) of where its ties/consumption are stronger. However, it could also be argued that the use by a company of the facilities and infrastructure of a State is a rationale that supports source, rather than residence, taxation. Nevertheless, the concept of economic nexus could still be used as a tie-breaker even if it is not used as a basis for residence taxation. It should be noted that such a concept being used in a residence tie-breaker is not unprecedented. For example, the individual tie-breaker uses *"centre of vital interests"* as a determining factor in deeming residence.
>
> 61. It may be that this option warrants further consideration on the appropriateness of such a test to confer residence. If so, the *consideration should be given as to what characterises economic connection to a State*.'[1129]

Moreover, the alternative of establishing a hierarchy of tests, as in the case of the tie-breaker for individuals, contemplated the following criteria:

> "71. The level or levels below would therefore deal with determinations regarded as the exceptions. A possible structure for such a hierarchy may be:
> - Place of effective management.
> - Place of incorporation.
> - *Economic nexus*; and
> - Mutual agreement."[1130]

In May 2003 the OECD published a discussion draft on the basis of the comments received to the above-mentioned proposals[1131]. The alternative of replacing the place of effective management test was not even considered, whereas the possibility of establishing a hierarchy of tests gave place to a proposal for new Commentaries to Art.4 OECD MC. Two aspects of this discussion draft are worthy of consideration: Firstly, that the place of incorporation was erased from the hierarchy, which is interesting if one considers that incorporation has been included in the context of the new version of the tie-breaker for break entities[1132]; and secondly, that the economic nexus criteria was included only as an alternative to the preferred method, which was the place of effective management. Although the 'economic nexus' test was ignored by the OECD, there are elements of the proposal which are quite relevant from a treaty abuse perspective:

> [OPTION A: 24.2 In some *rare cases* it may be impossible to make a clear determination of the State in which the place of effective management of the entity is situated or the facts may indicate that this place is situated in none of the Contracting States. […] In these cases subparagraph b) gives preference to the State with which the entity's economic relations are closer. The preference to the State with which the entity's economic relations are closer is based on the conclusion that, in such cases, the entity should be considered a resident of the Contracting State in which it is making greater use of economic resources as well as the legal, financial, physical and social infrastructures. The application of that test will involve examining various factors, such as in which State the entity has most of its employees and assets, carries on most of its activities, derives most of its revenues, has its headquarters, carries on most of its senior management functions or from which State the entity derives it (sic) legal status. If an examination of these and other relevant factors taken as a whole clearly shows that the entity is more economically related to one State than to the other, then it will be considered to be a resident of only that State.][1133]

Despite the relevance of all these observations in the current economic framework, and especially under the influence of the BEPS initiative, these proposals have not seen the light of day, and they

---

[1129] OECD, *The impact of the communications revolution*, supra note 1117, at pp.11-12.

[1130] Emphasis added. OECD, *The impact of the communications revolution*, supra note 1117, at pp.13-14.

[1131] OECD, *Place of effective management concept: Suggestions for changes to the OECD Model Tax Convention*, (Paris: loose-leaf, 2003).

[1132] Bearing in mind that the new tie-breaker takes into consideration which country's laws govern the legal status of the person, one may conclude that incorporation forms part of new tie-breaker, see OECD, Action 6: 2014 Deliverable, supra note 902, at p.80; and OECD, Action 6: 2015 Final Report, supra note 1, at p.74.

[1133] Emphasis added. OECD, *Place of effective management concept*, supra note 1131, at p.5.

probably never will[1134]. This is highly frustrating, taking into consideration the very interesting work carried out in the context of Action 5 of the BEPS Plan, when seeking to require substantial activities for the applicability of preferential regimes. In the case of intellectual property regimes, for instance, the nexus between the entity and the preferential regime has been observed from different perspectives. Elements such as the place where the expenditures to carry out an activity are in fact incurred, where the research and development takes place, and where the value is created, amongst others[1135], have been considered. Broadly speaking, the initiative has sought to subject the benefits of a preferential regime to the condition "that the taxpayer undertook the core income-generating activities required to produce the type of income covered" in that particular place[1136].

Considering the kind of solution the OECD has designed to deal with BEPS from a tie-breaker point of view, namely to bury the current test and to replace it by the Mutual Agreement Procedure, it is very likely that the proposals by the TAG group will be forgotten. Yet one needs to be very careful when stating that life of the 'place of effective management' test has come to an end. As will be discussed in the following paragraphs, although the OECD has left the impression that the place of effective management will be eliminated from the text of the Model[1137], a careful revision of the proposed Commentaries suggests that the current tie-breaker will not essentially change[1138]. In any case, an entity's economic activities will continue to be ignored for breaking such ties.

12.4.3. The after-BEPS Art.4(3) OECD MC: An updated tie-breaker for entities

12.4.3.1. Replacing the tie-breaker for entities

Although the BEPS Report of 2013 barely touched upon the issue of dual residence, the 2013 Action Plan clearly contemplated the need to neutralise the effects of hybrid mismatch arrangements in dual residence scenarios[1139] and, in general, to re-structure the tie-breaker for entities[1140]. The initiative put forward the need to prevent treaty abuse[1141], and many of the solutions proposed[1142] were at the same time highly relevant in the field of hybrid mismatch arrangements[1143]. Under the new rule, promoted in the context of the BEPS initiative:

> "The following are the changes that are proposed for that purpose:

[1134] According to the 2008 changes to the Commentaries, the failure of the proposal to establish a hierarchy of test was due to the resilience of most member States to abandon the 'place of effective management' test, see OECD, *The 2008 Update to the OECD Model Tax Convention*, (Paris: loose-leaf, 2008); also in van Weeghel, supra note 1097, at p.305. It is interesting to note that to some a hierarchy of tests may be considered "as a more complete answer to the issue", see Confédération Fiscale Européenne, 'Statement on Place of Effective Management Concept', in 43 *European Taxation* 12 (2003), at p.474.

[1135] OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance. Action 5: 2015 Final Report*, (Paris: loose-leaf, October 2015), at pp.24-25.

[1136] OECD, *Explanatory Statement. 2015 Final Reports*, (Paris: loose-leaf, October 2015), at p.14.

[1137] Although it is doubtful whether the States will renegotiate to modify this article in existing treaties.

[1138] In 2009 Plakhin suggested that despite the problems with the place of effective management test, there was little chance of an actual change occurring, see Plakhin, supra note 1115, at p.96.

[1139] See for instance the analysis of the situation through examples in OECD, Action 2: 2015 Final Report, supra note 820, at pp.336-340.

[1140] Problems, according to the OECD, arise "if more than one country seeks to apply such rules to a transaction or structure", see OECD, Action Plan, supra note 27, Action 2, at pp.15-16.

[1141] OECD, Action Plan, supra note 27, Action 6, at p.19.

[1142] OECD, Public Discussion Draft, supra note 27, at p.17.

[1143] OECD, Public Discussion Draft, supra note 510, at p.5.

Replace paragraph 3 of Article 4 of the Model Tax Convention by the following:

> 3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States."[1144]

There are two fundamental changes introduced by this new rule to the Model, which represent the essential features of the new test. Firstly, that the dual resident conflict in the case of persons other than individuals will no longer be solved unilaterally, but the States will have to *endeavour to determine*, based on a Mutual Agreement Procedure (MAP), which of those States will be considered as the State of residence[1145]. Secondly, that in the absence of such an agreement the person will not be entitled to any relief or exemption from tax provided by the Model, except where the authorities of both States so agree.

12.4.3.2. Solving the entity residence tie through Mutual Agreement Procedure

12.4.3.2.1. The *elimination* of the place of effective management test

As a consequence of the BEPS initiative, the OECD has proposed the elimination of the 'place of effective management' test, as it exists today. Under the new formula, the contracting Parties are meant to solve the issue through MAP and their agreement must be based on a multiplicity of elements, such as the place of effective management, the place where the entity was incorporated or otherwise constituted, and any other relevant factors.

When explaining how it is that the agreement between the States needs to be reached and the *other relevant factors* to do so, the OECD has explained:

> "Competent authorities having to apply paragraph 3 would be expected to take account of various factors, such as where the meetings of the person's board of directors or equivalent body are usually held, where the chief executive officer and other senior executives usually carry on their activities, where the senior day-to-day management of the person is carried on, where the person's headquarters are located, which country's laws govern the legal status of the person, where its accounting records are kept, whether determining that the legal person is a resident of one of the Contracting States but not of the other for the purpose of the Convention would carry the risk of an improper use of the provisions of the Convention etc."[1146]

This new version of the entity tie-breaker not only disregards the effectiveness of the economic attachment an entity may have with a certain State from the perspective of its activities, as the TAG Group so eloquently explained. It is also built upon the exact same considerations over which ties of residence in cases of entities are broken today. The 'place of effective management' does not only occupy a predominant role in the line of factors to be considered. When the OECD explains the additional elements to be kept in mind for breaking the tie, almost all those factors relate to, or are intrinsically connected with, the place of effective management as defined according to the Commentaries at different points in time[1147].

[1144] OECD, Action 6: 2014 Deliverable, supra note 902, at p.80; OECD, Action 6: 2015 Final Report, supra note 1, at p.72.

[1145] As Sasseville has noticed, it is relatively clear that this new tie-breaker is not an OECD's invention, but only a recognition of increasingly common practice in the field of treaties, see Sasseville, supra note 1096, at p.296.

[1146] OECD, Action 6: 2014 Deliverable, supra note 902, at p.82.

[1147] It considers the board of directors, for instance, despite the fact that it was added to the Commentaries in 2000 and erased from it in 2008.

Beyond the addition of the place of incorporation test to the criteria of Art.4(3) OECD MC (which does not really represent a significant improvement), the only real *reform* suffered by the tie-breaker for entities lies in the need to consider the potential misuse of the Model as a result of the application of the rule. However, this is something intrinsically connected with the manner in which the OECD MC defines abuse, which according to what has been stated repeatedly across the length of this study, is rather unclear.

If the question were raised as to whether this new tie-breaker changes the methodology through which entity residence ties are broken, the only crucial difference is the exclusion of dual resident companies from the *benefits* of the Model in the absence of an agreement between the parties. There is indeed no obligation to solve the dual residence conflict through MAP under the new rule, and this is a major change. However, while the new test certainly permits a more precise identification of the place where the company has *ties*, it does not appear that the activities of the company, the intensity of the nexus or the reasons giving rise to it, other than the same old reasons to confer residence to entities in the first place (mostly management activities), have been changed in essence. One cannot but observe that the rule will be more complex and the States will be prevented from making unilateral decisions, but this does not imply that substantial changes were proposed in 2015 to the Model.

One needs to assume that the OECD does not really want to replace the place of effective management of entities as a tie-breaker rule[1148] and, because of that, albeit indirectly, the test will continue to operate as the final solution for breaking those ties. The economic activities of the company, which under the TAG Group proposals were taken into consideration to build the link between a company and a State, have been fully ignored, and there is no reason to believe that, according to the new Commentaries, they should even be considered. One cannot but hope that in the context of the MAP the competent authorities will pay attention to this crucial aspect when solving a dual residence conflict, as part of the *other relevant factors* the rule allows them to consider.

12.4.3.2.2. Place of effective management and primary place of management

In close connection with the role of management activities in Art.4(3) OECD MC, it cannot be ignored that other additions have been proposed to the Model in the context of the BEPS project, which suggest that the management of an entity will not cease to be a protagonist for treaty entitlement purposes. The new LOB provision contains a rule according to which publicly traded entities that are not sufficiently connected with the relevant State so as to be defined as 'qualified persons', may nonetheless be considered as such, if they have their 'primary place of management and control' in that State.

The 'primary place of management and control' is defined in the following terms:

> 'd) a company's "primary place of management and control" will be in the Contracting State of which it is a resident only if executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial and operational policy decision making for the company (including its direct and indirect subsidiaries) in that Contracting State than in any other State and the staff of such persons

[1148] It subsists, in fact, as an alternative test for those States that want to use it. Nothing in relation to the alternative test prepared by the TAG Group was even considered in the field of BEPS, see OECD, Action 6: 2014 Deliverable, supra note 902, at p.82. Sasseville, in 2009, actually observed that after 51 years of analysis in relation to the concept of 'place of effective management', the OECD had gone back exactly to where it began, see Sasseville, supra note 1096, at p.297.

conduct more of the day-to-day activities necessary for preparing and making those decisions in that Contracting State than in any other State'[1149]

Despite the fact that the analysis of this concept largely supersedes the boundaries of this study, its similarity with the 'place of effective management' implies that there are some aspects of the term that are worthy of consideration[1150]. For instance, the purpose of this new term, according to the guidelines given by the LOB rule, is to demonstrate the effectiveness of the link between the entity and the State in which treaty benefits are claimed. The purpose of the rule is to consider the management of an entity as evidence of that entity's economic attachment with a State. This cannot but imply that the 'place of effective management' test was not removed from the Model due to its incapacity to measure the level of relevant substance behind an entity, but only because of the many interpretation issues related to its conceptualisation.

That being the case, it is evident that the 2015 changes to Art.4 OECD MC were not necessarily proposed in the light of the guidelines provided by the BEPS initiative because, at the outset, in the OECD's opinion, a test of management is effective enough in demonstrating an entity's level of economic connection with a given State. While this may be the reason why the 'place of effective management' test continues to be so relevant in the context of the new tie-breaker for entities, one cannot but wonder whether the questions posed by the BEPS initiative have been rightly approached when dealing with these aspects of Art.4 OECD MC.

The management test in the LOB provision and the new tie-breaker is considered to be enough to demonstrate the effectiveness of an entity's economic presence, but the economic activities of the entity are fully disregarded. In that context, it is fair to wonder whether the instruments the Model uses to measure the level of 'relevant substance' behind an entity are the more appropriate ones[1151]. The BEPS initiative has precisely raised the question of the appropriateness of the means tax treaties consider to grant its benefits, and yet the fundamental question of whether the existing methods or means to do so are adequate has been ignored. The BEPS project was the perfect excuse to look at these factors from an integral point of view and to discuss their

---

[1149] OECD, Action 6: 2015 Final Report, supra note 1, at p.50.

[1150] By way of illustration, the difficulties in assigning this term its meaning, see van der Weijden, supra note 948, at pp.305-306. The OECD has tried to underpin the differences between these two concepts. In simple terms, it appears that the 'primary place of management' is a more comprehensive version of the 'place of effective management'. According to the OECD, '[t]he term "primary place of management and control" […] must be distinguished from the concept of "place of effective management", which was used […] in paragraph 3 of Article 4 and in various provisions, including Article 8, applicable to the operation of ships and aircraft. The concept of "place of effective management" was interpreted by some States as being ordinarily the place where the most senior person or group of persons (for example a board of directors) made the key management and commercial decisions necessary for the conduct of the company's business. The concept of the primary place of management and control, by contrast, refers to the place where the day-to-day responsibility for the management of the company (and its subsidiaries) is exercised. A company's primary place of management and control will be situated in the State of residence of that company only if the executive officers and senior management employees exercise day-to- day responsibility for more of the strategic, financial and operational policy decision making for the company (including direct and indirect subsidiaries) in that State than in the other State or any third State, and the staff that support the management in making those decisions are also based in that State. Thus, the test looks to the overall activities of the relevant persons to see where those activities are conducted. In most cases, it will be a necessary, but not a sufficient condition that the headquarters of the company (that is, the place at which the chief executive officer and other top-level executives normally are based) be located in the Contracting State of which the company is a resident', see OECD, Action 6: 2015 Final Report, supra note 1, at p.50.

[1151] In 2005 Avery Jones proposed the need of a "more fundamental" look at the issue of entity dual residence, see Avery Jones, supra note 1123, at p.24. This question has been explored from the perspective of the tie-breaker for individuals. Schwartz, for instance, has explored the question of whether those tests are the correct ones, whether there should be a series of tests and, in that case, in what order they should be organised, and whether there are better tests to break residence ties, see Schwartz's comments in Avery Jones et al., supra note 86, at pp.659-664.

pertinence in current times, but only very limited and pragmatic aspects of this discussion have been confronted. Regrettably, a fine opportunity to scrutinise the OECD MC and the policy considerations at the heart of it was lost.

12.4.3.3. The effect of applying the new tie-breaker for entities

The last sentence of the new Art.4(3) OECD MC states:

> In the absence of such agreement [MAP], such person shall not be entitled *to any relief or exemption* from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States."[1152]

Bearing in mind the manner in which this provision has been drafted, the analysis of what the consequences are of applying the treaty tie-breaker is subject to a crucial distinction. On the one hand, there is the possibility of the MAP being successful. In such a case, it is more or less clear that the OECD will try to impose its traditional interpretation of the rule, introduced in 2008, to the effect of excluding the tie-breaker loser from the application of other treaties (with all the difficulties this entails)[1153]. One the other hand, the situation will be different if the States are not able to reach common ground and the MAP is therefore not successful. In that case, according to the new version of the Commentaries:

> "The last sentence of paragraph 3 provides that in the absence of a determination by the competent authorities, the dual-resident person shall not be entitled to any relief or exemption under the Convention except to the extent and in such manner as may be agreed upon by the competent authorities. *This will not, however, prevent the taxpayer from being considered a resident of each Contracting State for purposes other than granting treaty reliefs or exemptions* to that person. This will mean, for example, that the condition in subparagraph b) of paragraph 2 of Article 15 will not be met with respect to an employee of that person who is a resident of either Contracting State exercising employment activities in the other State. Similarly, if the person is a company, it will be considered to be a resident of each State for the purposes of the application of Article 10 to dividends that it will pay."[1154]

It is crucial to put emphasis on the limited effect of the absence of agreement between the contracting parties. In such a case, the dual resident entity will not be entitled to *treaty benefits*, that is to say, to relief or exemption (except if the authorities for some reason otherwise agree), but it will nonetheless still be considered as a resident for other treaty purposes. Thus, the residence requirements in rules such as Art.10 or Art.15 OECD MC will still be met, despite the lack of agreement as to the State of residence after the tie-breaker has been applied. The effects of the last sentence of the new version of Art.4(3) OECD MC are therefore circumscribed to the rules of relief or exemption, and not to the rest of the provisions of the treaty, for the purposes of which the residence requirement is relevant.

12.5. Evaluation: Breaking the tie under Art.4(2) and 4(3) OECD MC

Taking into consideration residence from a domestic point of view, the OECD MC breaks the tie between two States by giving preference to one tax claim over the other. The Model's tie-breaker, which in itself does not contain a definition of residence, nevertheless indicates the criteria to be used to break ties, along with the mechanism to apply the tests. When one looks at the policy

---

[1152] OECD, Action 6: 2014 Deliverable, supra note 902, at p.80; OECD, Action 6: 2015 Final Report, supra note 1, at p.72.

[1153] See Sec.8.2 of Comm. to Art.4 OECD Model Convention (2014). The OECD's interpretation of this rule has been largely explored in other parts of this study, see supra at pp.189; Chapter 2, at pp.20ff; Chapter 7, at pp.80ff, and Chapter 10, at pp.156ff.

[1154] Emphasis added, see OECD, Action 6: 2015 Final Report, supra note 1, at p.74.

objective behind the creation of the rule, it is fairly clear that the tests need to be defined at the international level. Only in that manner can it be sustained that Art.4(2) and (3) OECD MC contain a definition of residence for treaty purposes that is different from that in the laws of the contracting States.

The OECD has sought to introduce a certain interpretation of the tie-breaker in the Commentaries, according to which a person who loses the tie-breaker needs to be excluded from the scope of any other tax treaties concluded by the State in which the tie is lost. This interpretation, however, contradicts what the OECD has clearly expressed in the same Commentaries regarding the acquisition of the resident status: The Model seeks to impose no standards on domestic residents to be treated as treaty residents. If a person who loses a tie-breaker continues to be treated as a resident under domestic law after the tie has been broken, then it is relatively clear that, under the laws of that State, such person would continue to comply with the conditions imposed by the Model to establish residence. This is precisely the case that the OECD has targeted when promoting this new interpretation of Art.4 OECD MC. In other words, this person, who is a resident domestically (fully liable to tax), should nonetheless be excluded from the application of the Model after losing the tie-breaker. This interpretation is clearly undermined by the provisions of the Commentaries stating that the Model imposes no standards for domestic residents to access tax treaties. Insofar as it creates the impression that any person who overcomes the domestic residence test must be allowed access to the benefits of the Model, the mention of such an interpretation in the Commentaries should be eliminated. The argument that persons who lose the tie-breaker need to be excluded from the application of the Model under Art.4(1) second sentence of the OECD MC is not conclusive, precisely because of the manner in which the OECD has described the issue.

It cannot be forgotten that at some point during the history of the Model it was proposed that the definition of residence was to have an effect for the purposes of *this* Convention *and the internal laws* of the contracting States. Such proposal did nonetheless not progress. This idea underpins a fundamental aspect of the definition of residence, which is the relevance of defining very precisely the case to which the new interpretation of the tie-breaker applies, to avoid confusion. As was mentioned in the previous paragraph, if a person loses a tie-breaker, the person will not automatically be subject to limited tax liability (i.e. treated as a non-resident). This would only occur if the laws of the State in which the tie has been lost treat that person as a non-resident therefrom (as in the case of Canada and the UK). In such a case, the tie-breaker loser will not be considered to be a resident for the purposes of other treaties. This, however, will occur as a consequence of the application of the first sentence of Art.4 OECD MC (limited tax liability), and not of the second sentence (unlimited tax liability limited to certain income).

It may be sustained that the modifications introduced to the Commentaries in 2008 may have been motivated by the need to counter treaty abuse. However, as has been explained in other parts of this study, the inclusion of a second sentence to Art.4(1) OECD MC had nothing to do with abuse in the first place. Further, when one analyses the precise criteria used in the tie-breaker for individuals and entities from that particular perspective, it does not seem that the terms used in it have the purpose of adding relevant substance to the Model. On the contrary, the history of the Model demonstrates that the economic activities of the person had only a secondary role when determining which of the contracting States would win the tie. From a policy perspective, it is hard to imagine how it is that such a test may be destined to counter tax treaty abuse.

Assuming the need to address the issue of treaty abuse through a certain interpretation of the tie-breaker, it is curious, to say the least, that nowadays, in the context of BEPS, the OECD has turned a blind eye to the tie-breaker for individuals. Keeping in mind the definitions contained in the

BEPS Report, it is hardly deniable that artists, sportsmen, and other individuals are in fact able to segregate income from their sources. They are able to design dual residence schemes to abuse tax treaties, as the criteria used in the Model to break ties pays little attention to the effectiveness of the economic nexus between the individual and the relevant State. There is in fact case law on the matter, and the tax authorities of some States have had to fight these strategies by playing on and beyond the boundaries of the Model, and focusing, primarily, on their domestic tax rules. This is perhaps the reason why it is so outrageous that not a single word has been dedicated to the tie-breaker for individuals in the context of BEPS.

In the case of entities, on the other hand, a distinction must be made between the entity tie-breaker before and after the BEPS initiative. The BEPS project questioned the lack of economic attachment between the treaty claimant and the relevant State. The obvious question this raises is how to measure such an attachment. The work of the TAG Group has left it clear that the economic activities of a company may be quite illustrative of the place with which a company has a strong nexus from an economic point of view. Yet the OECD has ignored this, and seems to have preferred the place of effective management test, despite its regrettable origin, and the many interpretative issues it has generated over the years.

Under the new version of Art.4(3) OECD MC, proposed in 2015, it is the tax authorities of the States which will endeavour to solve the issue on the basis of the place of incorporation, place of management, and several other factors. If the tie is successfully broken, then the OECD's interpretation as to the effect of the tie-breaker needs to be applied to the tie-breaker loser. If, on the contrary, the authorities of both States do not reach an agreement, the dual resident taxpayer will not have access to any *relief or exemption* contained in the Model. This implies that the absence of agreement is not meant to deprive the treaty claimant of its characterisation as a treaty resident for other relevant treaty purposes, such as those derived from the application of Art.10 or Art.15 OECD MC, amongst other rules.

Bearing in mind the drafting of the new version of Art.4(3) OECD MC, one may easily conclude that there will be little consideration, if any, to the economic activities carried out by the entity when breaking the tie. Everything indicates that the place of effective management test will continue to play quite a preponderant role when doing so. The proposals by the TAG Group, which contained very detailed instructions of how to elaborate a test based on an effective economic nexus, were fully ignored for these purposes.

This, however, should not be surprising, for the OECD decided at a certain point in time that economic considerations were more appropriate for the purposes of source taxation rather than to the construction of residence. An explicit decision was made to use the personal dimension of the relevant taxpayer to break ties, instead of his effective economic attachment to a certain jurisdiction. While this explains the many difficulties in trying to attribute a meaning to residence that is significant from an economic point of view, the rise of treaty abuse as an international concern has changed the manner in which one needs to look at the Model. The question of profit shifting, for instance, is a question that aims at the heart of the OECD MC, namely the policy reasons which make its use *inappropriate.* The unsatisfactory results derived from the use of the Model are mainly connected with its inefficiency in protecting the balance between residence and source, and the tie-breaker is not an exception to these flaws. All these problems, however, are derived from a very precise cause, which is the lack of a satisfactory determination of the place with which the treaty claimant has an effective economic nexus on the basis of its rules, which is, again, a rather general concern.

If one looks at the issue from the perspective of the proposed additions to the Model, it may be the case that the new GAAR is employed to try to counter these strategies. Yet, as has been stated before, the scope of the rule is rather restricted and does not affect the characterisation of a person as a resident of a contracting State, at least not in a permanent manner. The same applies to the LOB rule, in respect of which it is evident that no barrier is put for individuals, for instance, to use the Model to shift profits. In the case of entities, the 'place of effective management' and thus the possibility of tax planning on the basis of it formally disappears. However, it cannot be ignored that the new guidelines pay little attention to the activities of the entity for breaking ties while perpetuating, at the same time, the management of such entities as a relevant factor to settle the issue.

One needs to understand that a permanent home can be purposely set up, that the place where a board of directors meet can be changed to a tax efficient location, but that an entity or individual will not be simply shifting its activities from one State to another with the view of optimising its tax burdens, in an opportunistic manner. All of this raises the question of whether the focus in current times, when conceptualising the test of residence and the tie-breakers, is the correct one. Perhaps rather than focusing on the tests themselves it is time to look at the Model as a whole and the manner in which these concepts materialise in a reasonable balance between residence and source. Sadly, in the context of the BEPS initiative, the opportunity to do so has not been taken.

The dual residence tests disregard, in general, the economic dimension of the relevant taxpayer. Under the Model and even under the new proposed rules residence ties are broken in the absence of an effective economic nexus. Considering all these apprehensions, it would not be strange if the tendency to ignore the rules contained in Art.4(2) and (3) OECD MC, and to replace them with a generic rule denying treaty entitlement in cases of dual residence, evolves into a common practice.