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Conflicts of Attribution of Income Involving Trusts under the OECD Model Convention: The Possible Impact of the OECD Partnership Report[1]

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1. Introduction

The OECD Model Tax Convention (OECD MC) is traditionally seen as aiming to eliminate international *juridical* double taxation, that is the imposition by the state of source and the state of residence of comparable taxes *on the same taxpayer* in respect of the same subject matter for identical periods. Under this line of reasoning, it is therefore arguable that the distributive rules of the OECD MC (Arts. 6–22) only apply where both Contracting States allocate the relevant treaty favoured item to the same taxpayer.

Fifteen or twenty years ago, this requirement was in most cases not problematic, at least for two reasons. First, the attribution rules of tax systems were, broadly speaking, very similar. Secondly, at that time the exchange of goods, services and the movement of persons were not truly international. Over the past ten years, however, the globalization of the world's economy and the growing mobility of persons, have led taxpayers increasingly to have recourse to legal arrangements the income of which is not attributed to the same taxpayer by the source country and the residence state (so-called 'hybrid entities'). In these instances the use of such hybrid entities, typically partnerships, trusts and investment funds, creates a conflict of attribution of income (*Zurechnungskonflikt*)[2] which, under the traditional definition of international juridical double taxation exposed above, may typically lead to double taxation (or double non-taxation) of dividends, interest and royalties.[3]

In 1993 the OECD formed a working group to study the application of the OECD MC to such type of entities. On 20 January 1999 the Partnership Report,[4] the first document produced in this field and the conclusions of which have been incorporated in the 2000 update of the OECD Commentary, was adopted. The OECD Partnership Report discusses various situations in which the Contracting States disagree with respect to the person to whom the partnership income is to be assigned for tax purposes. While the scope of this report is limited to partnerships, the OECD has nevertheless already indicated that many of the principles discussed in the partnership report were also likely to be applicable to trusts.[5] Furthermore, it is our understanding that the OECD will, based on the experience acquired through its partnership report, ultimately produce a study pertaining to trusts and investment funds.

The present contribution discusses conflicts of attribution involving trusts and explores the impact the Partnership Report could have in this area. To that end, we shall first illustrate how conflicts of attribution may arise in the field of trust relationships. We shall then demonstrate that the text, context as well as the object and purpose of tax treaties patterned upon the OECD MC dictate that these difficulties be resolved. Accordingly, we shall finally examine whether, and if so under which conditions, conflicts of attribution involving trusts could be resolved by relying on the general recommendation embodied in the Partnership Report. Before moving on, however, let us first review the origin of conflicts of attribution in a treaty context.

Notes

1 The present contribution summarizes certain ideas expressed in our doctoral thesis. For a more extensive analysis of the issues discussed in this article thus see Robert J. Danon, *Switzerland's direct and international taxation of private express trusts, doctoral thesis* (Uni. Geneva, 2004), published by Schulthess (www.Schulthess.com)/Linde Verlag/Bruylant/Westlaw. Comments on this article are welcome at *robert.danon@bakernet.com*.

2 Klaus Vogel, *On Double Taxation Conventions*', 3rd ed. (Kluwer, London, the Hague, Boston, 1997), p. 53, no. 91a.

3 Robert Danon and Hugues Salome, 'Avoidance of Double Non-Taxation' (Swiss national report) in (ed. Michael Lang), *Schriftenreihe zum Internationalen Steuerrecht*, vol. 26 (Vienna, 2003), p. 389.

4 OECD, 'The Application of the OECD Model Tax Convention to Partnerships' in *Issues in International Taxation Series*, no. 6 (Paris, 1999).

5 OECD Partnership Report, II.1.1, p. 7.

2. Conflicts of attribution under the OECD MC

A. The origin of conflicts of attribution in a treaty context

Tax treaties can be seen as international agreements aimed at promoting international commerce and investment[6] through the avoidance of international double taxation. As mentioned, a tax treaty allocates taxing jurisdiction between countries through a set of distributive rules (Arts. 6–22 of OECD MC),[7] which entail a restriction of domestic tax claims in areas where they are expected to, or at least theoretically may, overlap.[8] By contrast, tax treaties do not lay down the principles that govern the taxation of an item of income in the country to which they allocate a taxing right.[9] In particular, tax treaties patterned upon the OECD MC do not provide rules determining to which person (tax subject)[10] income should be attributed. In other words, as observed by Ault, the distributive rules deal with the treatment of specific items of income or capital, but do not link those items to specific taxpayers.[11]

At the same time, however, the application of a tax treaty presupposes a connection between the treaty favoured income (tax object) and a given taxpayer (tax subject).[12] In our opinion, this condition flows from the language of the distributive rules, which by using terms such as 'derived *by*',[13] 'profits *of*',[14] 'income *of*',[15] 'paid *to*',[16] clearly express a personal attribution of income requirement.[17]

Further, in our opinion, this requirement should not be confused with the 'beneficial ownership test' embodied in the dividends, interest and royalties articles. Indeed, while the terms 'paid to'/'derived by' crystallize the need for a connection between the relevant item of income and a taxpayer, the beneficial ownership test, on the contrary, is of a different nature and pursues another goal, namely to tackle the improper use of tax treaties and more specifically treaty shopping schemes adversely affecting the source state.[18] Accordingly, for the purpose of the application of the distributive rules one should first seek to determine whether the income has been 'derived by' a resident of the other Contracting State. If this question is answered in the affirmative, then the question of whether this person satisfies the 'beneficial ownership' requirement must, in addition, be addressed.

In the absence of an autonomous[19] definition of the terms 'paid to'/'derived by', the question naturally arises as to how the latter are to be construed. It is *prima facie* arguable that when putting the term 'paid to'/'derived by' into effect, Contracting States may, pursuant to Art. 3, para. 2 of OECD MC,[20] refer to their domestic attribution rules.[21] Under this analysis, the meaning of these words would thus be ascertained by reference to the internal law of the state applying the treaty.[22] For example, the source country would only accept to reduce its withholding tax on a dividend if, under its own allocation principles, the latter is

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6 Alexander Easson, 'Do we Still Need Tax Treaties', in BIFD, December 2000, p. 622.

7 OECD, *Commentary on Model Tax Convention on Income and on Capital, Paris* (2003), introduction, para. 19; Kees Van Raad, 'International Coordination of Tax Treaty Interpretation and Application', in *Intertax* 2001, p. 212 *et seq.*; Xavier Oberson, *Précis de droit fiscal international*, 2nd ed. (Bern, 2004); Easson, see n. 6 above, p. 622; Steven Van Weeghel, *Improper Use of Tax Treaties*, thesis (Kluwer, Deventer, 1997), p. 33; Vogel, see n. 2 above, p. 39, no. 74; Johannes Heinrich and Helmut Moritz, 'Interpretation of Tax Treaties', in ET, April 2000, p. 142.

8 Vogel, see n. 2 above, p. 26, no. 45c; see in the same vein *Revue de Droit Administratif et de Droit Fiscal* (RDAF) (Lausanne, Switzerland, 2000), pp. 495 and 499.

9 Jean-Marc Rivier, *Droit fiscal suisse. Le droit fiscal international* (Neuchâtel, 1983), p. 106; Jean-Marc Rivier, 'L'interprétation des Conventions de double imposition', in RDAF, see n. 8 above, p. 113 *et seq.*; RDAF, n. 8 above, pp. 495 and 499.

10 Richard L. Doernberg and Kees Van Raad, 'Hybrid Entities and the U.S. Model Income Tax Treaty', in Tax Notes Int'l, August 23 1999, p. 745 *et seq*. In the same vein Van Raad, see n. 7 above, p. 215.

11 Hugh J. Ault, 'Issues Related to the Identification and Characteristics of the Taxpayer', in BIFD 2002, p. 263.

12 Brian J. Arnold *et al*. 'Summary of the Proceedings of an Invitational Seminar on Tax Treaties in the 21st Century', in BIFD 2002, p. 242; Danon and Salome, n. 3 above, p. 388; Gutmann *et al*., 'Point de vue franco-suisse sur l'arrêt Société Schneider Electric du 28 juin 2002 – Réflexion sur le problème de l'attribution du revenu en droit fiscal international', in RDAF, 2002, n. 8 above, p. 292; Vogel, see n. 2 above, p. 29, no. 48.

13 Arts. 6, para. 1, 15, para.1, 16, para.1 and 17, para. 1 of OECD MC.

14 Art. 7, para. 1 of OECD MC.

15 Art. 21, para. 1 of OECD MC.

16 Arts. 10, para. 1, 11, para. 1, 18, para. 1, 19, para. 1 of OECD MC.

17 See Danon and Salome, n. 3 above; Hugues Salome, *International Taxation of Partnerships: Divergences in the Personal Attribution of Income* (Zurich, Brussels, 2002), p. 62; Arnold *et al*., see n. 12 above, p. 240.

18 For an analysis of the beneficial ownership requirement, see Danon, thesis, pp. 326 *et seq*. (in general and in the field of trusts); see also in general among others Charl P. du Toit, *Beneficial Ownership of Royalties in Bilateral Tax Treaties*, thesis (IBFD, Amsterdam, 1999); Jürgen Killius, 'The concept of beneficial ownership of items of income under German tax treaties', in *Intertax* 1989/8-9, p. 340 *et seq*.; IFA, 'The OECD Model Convention – 1998 and beyond; The concept of beneficial ownership in tax treaties', Proceedings of a Seminar held in London in 1998 during the 52nd Congress of the International Fiscal Association, vol. 23a (The Hague, London, Boston, 2000), p. 561, no. 6; Oberson, n. 7 above, p. 135, no. 434; see also Swiss Federal Court of Appeal Decision of 28 February 2001, StR 2002 36.

19 Danon and Salome, n. 3 above, p. 388.

20 Van Raad, n. 7 above, p. 215; Ton H.M. Daniels, *Issues in International Partnership Taxation, thesis* (The Hague), p. 157.

21 Michael Lang, *The Application of the OECD Model Tax Convention to Partnerships – A Critical Analysis of the Report Prepared by the OECD Committee on Fiscal Affairs* (Vienna, 2000), p. 32; Daniels, n. 20 above, p. 153.

22 Van Raad, n. 7 above, p. 215.

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'paid to'/'derived by' a resident of the other state.[23] It is precisely this lex fori characterization of the terms 'paid to'/'derived by' embodied in the distributive rules which, as we shall now see, may well lead to conflicts of attribution in the area of trust relationships.

B. Conflicts of attribution involving trusts

1. The trust concept and the issue of fiscal attribution of trust income

The common law trust is structured as a triangular relationship whereby one person (the settlor) transfers, by way of an act of unilateral nature, property to another person (the trustee), the latter then having an obligation to deal with or hold that property for the benefit of a third person (the beneficiary). The assets held in trust constitute a segregated fund and are not part of the trustee's personal estate.[24]

Depending on the rights of the beneficiaries, a trust is typically classified as 'fixed' or 'discretionary'. A fixed trust is one in which a beneficiary has a current fixed entitlement to an ascertainable part of the net income of the trust fund (after deduction of sums paid by the trustees).[25] In a traditional discretionary trust, on the contrary, the trustee has authority both to choose beneficiaries out of a given class of persons and to determine how much each of these persons shall receive. As a result, in a discretionary trust a beneficiary has no absolute current right to direct the trustees to pay him an ascertainable part of the net income or corpus of the trust.[26] Rather, it is only once the trustee has made use of his discretion by positively deciding to pay funds to the beneficiary that the latter can force such distribution.[27] The trustee may decide (or be compelled) to exercise his discretion on a current basis (discretionary current trust) in which case the arrangement resembles, in terms of the timing of the distributions made to the beneficiaries, a fixed trust. Alternatively, on the contrary, the trustee may also decide (or be compelled) to accumulate the items of the trust for later distribution to members of a class of beneficiaries (discretionary accumulation trust). Such an accumulation may however also occur where, for example, the beneficiaries of the trust are unborn (contingent future beneficiaries).

From the perspective of the settlor, the distinction is usually made between the *irrevocable* and *revocable* nature of the trust. In an irrevocable trust, the settlor cannot terminate the settlement and thus completely drops out of the picture. A trust is on the contrary revocable where the settlor wishes to have the possibility to recover the trust assets at a given time. Under English law, a power to revoke is a valid reservation which does not prevent the trust from existing *ab initio* and the beneficiaries from acquiring an interest in the trust at the outset. Further, a power of revocation produces no retroactive effect in the sense that the settlor may only recover what remains in the trust fund at the time of the revocation.[28] Finally, instead of reserving himself a power to revoke the trust, the settlor may simply wish to retain the power to designate additional beneficiaries including (general power of appointment) or excluding himself (special power of appointment).

Based on the foregoing features, it is up to each jurisdiction, relying on tax policy considerations, to decide to whom (trust, trustee, beneficiary or settlor) and under which conditions the items of a trust are to be attributed for tax purposes.

It is fair to say that common law states usually assess a trust relationship under a so-called 'hybrid' tax model. Indeed, pursuant to this model, the items of the trust that are to be distributed to the beneficiaries (fixed/discretionary current trusts) on a current basis are fiscally attributed (either directly or under a flow through regime) to the latter. In these instances, therefore, the tax treatment of a trust bears certain analogies with the regime applied by certain jurisdictions to fiscally transparent partnerships. By contrast, however, the income of the trust which is accumulated is usually attributed to the trust or to the trustee.[29] Specifically, the retained trust items are in general subject to tax in the hands of the trust/trustee according to the rules applicable to the taxation of individuals. In order to avoid economic double taxation of trust income, the subsequent distribution is then tax-exempt in the hands of the beneficiaries. Under this system, the taxes paid by the trust/trustee are thus designed to anticipate and replace those which would have been ultimately due by the future beneficiaries of the trust. In addition, where the settlor retains rights under the trust (power to revoke, power of appointment), certain (but not all) common law jurisdictions have chosen to disregard the trust and to attribute its elements directly to the settlor (so-called 'grantor trust' rules).[30]

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23 See Daniels, n. 20 above, p. 153.

24 See the definition given by Art. 2 of the Hague Convention of 1 July 1985 on the Law Applicable to Trusts and their Recognition; Arhur Underhill and David J. Hayton, *Law of trusts and trustees*, 16th ed. (London, 2003), p. 3.

25 *Ibid*., p. 63.

26 *Ibid*., p. 63; Jon H.I. Grouf and Judith A. Gelb, 'Avoiding U.S. Trust Wars', in *Disputes Involving Trusts* (Basel, 1999), p. 154.

27 Grouf and Gelb, see n. 26 above, p. 155; Underhill and Hayton, see n. 24 above, p. 63.

28 David J. Hayton *et al*., *The Principles of European Trust Law* (The Hague, 1999), p. 63.

29 This tax liability does not affect nor concern the trustee's tax liability on his personal items.

30 For an analysis of the features and policy objectives shaping trust taxation in common law states, see Danon thesis, pp. 59 *et seq*.

Civil law states, on the contrary, have in general not yet addressed to issue of trust taxation from a tax policy perspective. Consequently, in these jurisdictions the question of fiscal attribution of trust income is often resolved on the basis of an assimilation of the various components of the trust relationship to civil law concepts used by the tax statute.[31]

In light of the various different rules which a state may choose to adopt when dealing with fiscal allocation of trust income, it will thus come as no surprise that in this area conflicts of attribution are likely to occur frequently between the state of source and the state of residence in a treaty context. While it is arguable that these conflicts concern primarily civil law and common law jurisdictions, it is however also conceivable for such conflicts to occur between two Anglo-Saxon countries (for example where only one of the states involved attributes trust income to the settlor pursuant to grantor trust rules).

We shall thus now try to illustrate some of these conflicts by relying, for this purpose, on the following symbols:

——————→	Indicates the attribution rules of the source state
············→	Indicates the attribution rules of the residence state
T	= trust/trustee
B	= beneficiary
S	= settlor

2. *Case 1: discretionary accumulation trust*

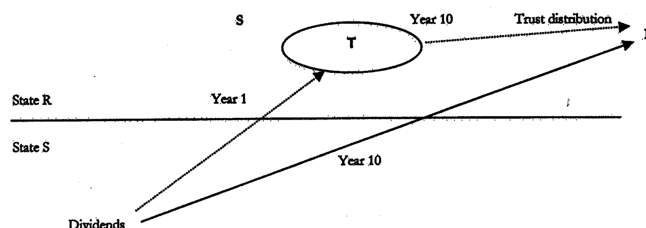
(a) Facts

T is an irrevocable discretionary accumulation trust resident in a common law jurisdiction, state R, for treaty purposes. In year 1, T derives dividends from a civil law jurisdiction, state S that it decides to accumulate. These dividends are subject to a withholding tax in state S. In year 10, T selects B, a state R resident individual, among a class of potential beneficiaries and distributes to him an amount equaling the dividends.

As is the case in several common law jurisdictions, under the laws of state R the accumulated trust income derived in year 1 is attributed (and taxed) to T. In order to avoid economic double taxation of trust income, state R treats the subsequent distribution to B as a tax-exempt capital transfer.

The concept of trust, on the contrary, is alien to state S legal and tax system. As a result, state S does not treat T as a separate taxpayer and does not allocate trust income to the latter. Rather, under the laws of state S, the only person to whom the income could potentially be fiscally allocated is B who is, however, unknown in year 1. Accordingly, from the perspective of state S, an attribution of income in the hands of a recipient of state R would only take place in year 10 that is when the trustee's discretion is exercised in favour of B.

The S-R treaty is patterned upon the OECD MC.



(b) Application of domestic attribution rules in a treaty context

If it were to construe its tax treaty with state R by reference to its internal law, state S could, in this situation, contend that the S-R treaty is not applicable. Specifically, not allocating the dividends to a state R resident in year 1, state S could put forward that in year 1 these dividends were not 'paid to'/'derived by' a resident of state R. Under this analysis, state S could consequently argue that it is under no obligation to reduce its withholding tax to the appropriate treaty rate.

In state R, by contrast, the state S dividends would be fiscally imputed and taxed to T as accumulated income in year 1. However, while it would tax the full amount of the dividend, state R would only be obliged to provide double taxation relief with respect to taxes levied *in accordance* with the S-R treaty.[32] As a result, the state S withholding tax would not be completely creditable by T against its tax liability in state R.[33] As can be seen, an interpretation of the term 'paid to'/ 'derived by' *lege fori* leads to double taxation of accumulated trust income.

On the contrary, if the attribution rules of state S had been identical to those of state R, a strict application of internal law would not have entailed any double taxation. That is, in year 1 state S would have viewed the dividend as having been 'paid to'/ 'derived by' a resident of state R and hence the relevant amount of its withholding tax would have been refunded. Moreover, the residual portion of the withholding tax would have been fully creditable by T in state R.

In the same vein, let us now illustrate another set of comparable difficulties by moving the residence of B to state S.

Notes

[31] Ibid., p. 170 *et seq*.

[32] See Art. 23A and B of OECD MC.

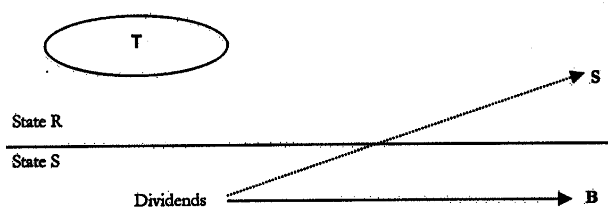
[33] For a similar analysis in the field of partnerships, see Daniels, n. 20 above, p. 155.

3. *Case 2: grantor trust with a state S resident beneficiary*

(a) Facts

T is a revocable fixed interest trust established under the laws of state R. The settlor of T, S, is a state R resident individual. Under the settlement, S holds a power to revoke that triggers the state R grantor trust rules. The beneficiary of T, B, holds a vested estate for life and therefore is entitled to receive all periodical income derived by T. B is a state S resident individual. In 2003, T derives dividends, interest and royalties from state S.

In accordance with so-called 'grantor trusts' rules, state R attributes the income derived by T to S. For state S, on the contrary, the income derived by T is attributable to B. Indeed, state S solely relies on the fact that B here acquires a vested interest under trust law. The S-R treaty is patterned upon the OECD MC.



(b) Application of domestic attribution rules in a treaty context

Relying on its internal law, state S could analyze this case as a purely internal matter. That is, local source dividends accruing directly to B, one of its residents holding a fixed right to receive these items. As a result, state S could argue that because under its domestic tax law B is regarded as the taxpayer, the income arising in its territory has not been 'paid to'/'derived by' a resident of state R. State S could thus contend that the dividends are to be classified as other income (Art. 21 of OECD MC). Under this interpretation, state S would thus be allowed to tax the income without any restriction.

By contrast, state R would treat S as the recipient of the state S source income. It may very well be however that the domestic tax law of state R would, in such case, not grant S a credit for the income taxes paid by B in state S.

Accordingly, both state S and state R would tax the same item of income during an identical period of time but in the hands of different taxpayers. Again, this double taxation would be entirely due to a divergence in the personal attribution of trust income. Indeed, if, under its domestic tax law, state S had assigned the dividends to S, it would have viewed these items as being 'paid to'/'derived by' a resident of state R. As a result, a tax sharing would have taken place and double taxation of dividends arising in state S would have been avoided.[34]

In this context, it is interesting to observe that the US and the UK have identified the double taxation issue that could stem from such divergences in the attribution of trust income.

Specifically, the exchange of notes to the US–UK Tax Treaty 2001 expressly provides for double taxation relief in such a situation:

> 'In the case where the same item of income, profit or gain derived through a trust is treated by each Contracting State as derived by different persons resident in either State, and a) the person taxed by one State is the settlor or grantor of a trust; and b) the person taxed by the other State is a beneficiary of that trust, the tax paid or accrued by the beneficiary shall be treated as if it were paid or accrued by the settlor or grantor for the purposes of determining the relief from double taxation to be allowed by the State of which that settlor or grantor is a resident (or, in the case of the United States, a citizen).'[35]

Let us finally consider the same case but by moving the residence of B to a third state (triangular case).

4. *Case 3: triangular case involving a grantor trust*

(a) Facts

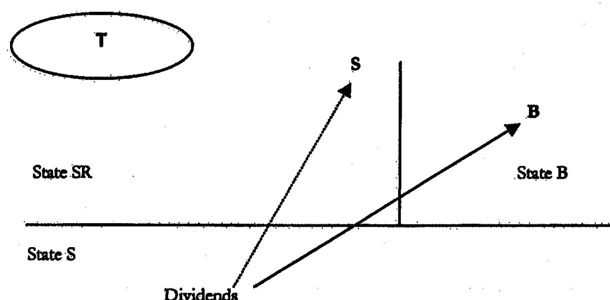
T is a revocable fixed interest trust established under the laws of state R. The settlor of T, S, is a state SR resident individual. Under the settlement, S holds a power to revoke that triggers the state SR grantor trust rules. The beneficiary of T, B, holds a vested estate for life and therefore is entitled to receive all periodical income derived by T. B is a state B resident individual. In 2003, T derives dividends, interest and royalties from state S.

In accordance with so-called 'grantor trust' rules, state SR attributes the income derived by T to S. For state S, on the contrary, the income derived by T is attributable to B. Indeed, state S solely relies on the fact that B here acquires a vested interest under trust law.

Notes

[34] See Art. 10 of OECD MC.

[35] Exchange of notes to the new US–UK Treaty 2001 and Art. 24 (Relief from double taxation).



The S-R treaty is patterned upon the OECD MC.

(b) Application of domestic attribution rules in a treaty context

As in the preceding case, B would be viewed as the recipient of the income from the perspective of state S. Accordingly, state S could argue that its treaty with state SR does not apply since, under its domestic tax law, the dividends would not be 'paid to'/'derived by' a resident of state SR, but rather by B, a resident of state B. Under this analysis, state S would therefore consider that it may tax the dividends arising in its territory regardless of its treaty with state SR. At the very best, state S would only be prepared to apply its treaty with state B, if any. By contrast, state SR would allocate and tax the dividends to S, one of its residents (likely without granting a credit to S for the income taxes paid by B). As a result, double taxation of the same item of income in the hands of different taxpayers would occur.

5. Conclusion

The above-mentioned examples illustrate that the differences with respect to personal attribution of trust income may lead to double taxation. These situations stem from the strict application by the state of source of its diverging allocation rules. Let us now examine the reasons that militate in favour of a resolution of these conflicts in a treaty context.

3. The need to solve conflicts of attribution

A. The issue

The form of double taxation to which divergences in the attribution of income give rise is not strictly speaking juridical. That is, taxes are not levied on the same taxpayer.[36] Rather, this phenomenon may be described as a form of economic double taxation in the sense that the same income is taxed by two states in the hands of different taxpayers.[37] In our opinion, this sort of double taxation should however be distinguished from that taking place in a classical corporate tax system where a profit is first subject to corporate income tax at the level of the company, and second, taxed as investment income at the level of the shareholder when distributed. Clearly, the OECD MC does not intend to remove the latter as its dividend Article states that it:

> 'shall not affect the taxation of the company in respect of the profits out of which the dividends are paid'.[38]

Furthermore, in our opinion, the form of double taxation generated by a conflict of attribution also differs from that created by an upward profit readjustment operated within the limits of Art. 9, para. 1 of OECD MC and neutralized by a matching adjustment pursuant to Art. 9, para. 2 of OECD MC. Unlike the other distributive rules, this provision deals with the relationship of two states of residence and the taxation of legally independent taxpayers, each of them by his state of residence.[39] It is thus aimed at solving a 'residence-residence' conflict by avoiding economic double taxation of the same profits in the hands of two resident associated enterprises.[40] By contrast, we are here dealing with a type of double taxation occurring in 'residence-source' conflicts as it entails taxation in the state of residence and in the state of source.[41]

B. The text of the dividends, interest and royalties Articles

In accordance with Art. 31 of the Vienna Convention,[42] the interpretation of a treaty provision begins

Notes

36 See OECD Commentary para. 1 and Introduction.

37 See in the same vein Vogel, n. 2 above, p. 10, no. 3.

38 Art. 10, para. 2 *in fine* of OECD MC. As convincingly observed by Kees Van Raad, 'Recognition of foreign enterprises as taxable entities (General Report)', in CDFI 1988, vol. LXXIIIa, p. 33: 'This type of economic double taxation which concerns the transfer of income from one person to the other is well known . The type of economic double taxation that is addressed is of a different nature. This double taxation does not result from two persons being taxed in succession for income that passes from one person to the other. It involves two persons who are simultaneously taxed for the same income, as a result of a difference in the designation of the taxable person between the two taxing authorities involved.'

39 Vogel, n. 2 above, p. 518, no. 10.

40 See OECD Commentary para. 5 and Art. 9, para. 2 of OECD MC; Salome, n. 17 above, p. 72.

41 Danon and Salome, n. 3 above, p. 398. Lang, by contrast, arrives at the conclusion that economic double taxation stemming from diverging allocation rules must not be eliminated, as it does not fall into the scope of the cases covered by Art. 9 of OECD MC; Lang, n. 21 above, pp. 29, 56 and example 4, p. 58 and example 5.

42 Vienna Convention of 23 May 1969 on The Law of Treaties (VC).

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by considering its literal wording.[43] In our opinion, the text of the dividends, interest and royalties Articles (as well as that of other similar distributive rules) does not reveal that these provisions only apply where the Contracting States' internal law attribute the relevant item of income to the same taxpayer. Rather, these Articles solely regulate the allocation of taxing rights between the two jurisdictions.[44] For example, the dividend Article simply refers to 'dividends paid by ... a resident to a resident of the other Contracting State', but does not stipulate which person the Contracting States are to regard as the recipient of the dividend for tax purposes. In fact, it is logical to argue that the distributive rules may not call for an 'identity of tax subject', since they do not designate the tax subject to whom the income is to be attributed.[45] It is therefore submitted that, apart from cases of economic double taxation stemming from a classical system (Art. 10, para. 2 *in fine*), nothing in the plain language of the dividends, interest and royalties articles of the OECD MC indicates that its scope of application is limited to the avoidance of juridical double taxation. In other words, in our view, the text of these provisions does not suggest that the latter should become ineffective where the income they deal with is taxed in the hands of different taxpayers, as this may occur in the field of trust arrangements.

C. The context

It is generally admitted that in order to correctly interpret a particular treaty Article, the latter must also be considered in its nexus with other provisions (contextual or systematic interpretation).[46] In our view, a systematic argument that supports the elimination of double taxation stemming from a conflict of attribution is the relationship existing between the residence Article (Art. 4, para. 1 of OECD MC) and the distributive rules. Indeed, the concept of treaty residence constitutes the prerequisite to the application of the distributive rules and thus to the elimination of 'residence-source conflicts'. However, as convincingly observed by Vogel[47] and Daniels,[48] the designation of a person as a resident of a Contracting State becomes meaningless, if the source state may bypass this person by contending that, under its own interpretation of the terms 'derived by/'paid to', the relevant distributive rule does not apply. Therefore, in our opinion, the need to maintain a consistency between the function of treaty residence and the distributive rules confirms that a lack of convergence between the Contracting States with respect to the personal attribution of income should not prevent their application.

D. The object and purpose of the distributive rules

Some support for the foregoing conclusion may also be found in the object and purpose of the distributive rules (teleological interpretation). That is, it is beyond doubt that the aim of these provisions is the avoidance of double taxation through the allocation of taxing claims among the Contracting States. Together with others we believe that, in this area, the interpretation that best serves this goal is decisive.[49] Therefore, contending that divergences existing between two Contracting States in the field of attribution of income should not prevent the distributive rules from fulfilling their function is indeed the most convincing interpretation.[50] Moreover, this analysis does not go beyond the scope of these rules since, as we have seen, their plain language confirms that they are not limited to the elimination of juridical double taxation.

E. The OECD Commentary

As we have seen, there is a tendency to consider that the OECD MC only intends to eliminate juridical double taxation.[51] In particular with respect to Art. 23A and 23B, the OECD Commentary distinguishes clearly juridical from economic double taxation:

'These articles deal with the so-called juridical double taxation where the same income or capital is taxable in the hands of the same person by more than one State.[52] This case has to be distinguished especially from the so-called economic double taxation, i.e.

Notes

43 See *inter alia* Vogel, n. 2 above, p. 37, no. 69; Ekkehart Reimer, 'Interpretation of Tax Treaties', in ET 1999, p. 458 *et seq*., p. 462; Rivier, n. 9 above, p. 12; Oberson, n. 7 above, p. 25, no. 80; Peter Locher, *Einführung in das internationale Steuerrecht der Schweiz*, 2nd ed. (Bern, 2000), p. 107; see also Swiss Federal Tribunal Judgment of 17 February 1971, ATF 97 I 364 = ASA 41, 470.

44 See Arts. 10, 11 and 12 of OECD MC.

45 Danon and Salome, n. 3 above, p. 399; Salome, n. 17 above, p. 73.

46 Reimer, n. 43 above, pp. 459 and 464; Locher, n. 43 above, p. 109; Peter Locher, *Interpretation of Double Taxation Conventions*, (National Report for Switzerland), in CDFI, Volume LXXVIIa, 1993, p. 581; Heinrich and Moritz, n. 7 above, p. 147.

47 Vogel, n. 2 above, p. 94, no. 24a.

48 Daniels, n. 20 above, pp. 159 and 164.

49 Ernst Höhn, *Handbuch des Internationalen Steuerrechts der Schweiz*, 2nd ed. (Bern, 1993), p. 77; Oberson, n. 7 above, pp. 23–24, no. 73.

50 Supporting the teleological argument, Vogel, n. 2 above, p. 94, no. 24a; Daniels, n. 20 above, p. 159; Salome, n. 17 above, p. 46.

51 Oberson, n. 7 above, p. 5, no. 14; Vogel, n. 2 above, p. 553, no. 69; Lang, n. 21 above, pp. 29, 56 and example 4, p.58 and example 5. Except within the scope of Art. 9 of OECD MC

52 OECD Commentary, para. 1 and Art. 23A and 23B.

where two different persons are taxable in respect of the same income or capital.'[53]

By considering that the OECD Commentary conveys here the ordinary meaning (Art. 31, para. 1 of VC) of these provisions, one could thus be tempted to maintain, that the type of double taxation stemming from a conflict of attribution does not fall into the scope of the OECD MC.[54] It is questionable, nevertheless, whether the references made by the OECD Commentary to juridical and economic double taxation were really intended to narrow the scope of the OECD MC in this fashion. Indeed, other references made by the OECD Commentary to this issue tend to show that the initial intention was rather to differentiate juridical from economic double taxation created by a classical corporate tax system.[55] After all, 15 or 20 years ago economic double taxation was essentially known in this form. By contrast, economic double taxation created as a result of diverging domestic attribution rules was, as explained earlier, much less frequent. Today, on the contrary, these situations have become practically inevitable[56] as vehicles such as trusts and partnerships that are not identically classified by both Contracting States tend to be used more and more in a treaty context. Because the text of the distributive rules as well as their object and purpose do not at all indicate that their application should be restricted to cases where the parties attribute the income to the same taxpayer, it is submitted that this general reference made by the OECD Commentary to juridical double taxation may not be used to support the fact that the allocation of income in the hands of different taxpayers prevents the application of the distributive rules.

F. Synthesis

The foregoing considerations allow us to conclude that the application of tax treaties patterned upon the OECD MC should, in the context of a *residence-source conflict*, not be affected by differences existing between the Contracting States in the area of attribution of income. In our view, therefore, an interpretation of the words 'derived by'/'paid to' *lege fori* is not appropriate. Rather, the context of Art. 3, para. 2 of the OECD MC here requires a different interpretation. Among the possible contextual interpretations is that suggested by the 2000 update of the OECD Commentary further to the OECD Partnership Report. This Report indeed addresses conflicts of attribution of income created by a diverging fiscal classification (i.e. transparency versus non-transparency) of partnerships. While, as we shall see, these latter issues are very similar to those we have illustrated in the field of trusts, we do not, however, believe that the changes which were made to the OECD Commentary as a result of this Report may, without further analysis, be regarded as revealing the general ordinary meaning of the terms 'derived by'/'paid to' and hence be applied automatically to trusts. Rather, in our view, it is necessary to analyze whether the solution proposed by the CFA may be considered as reflecting the appropriate contextual interpretation of these terms.[57] It is only if this question is answered in the affirmative that the principles of the OECD Partnership Report will be applicable to conflicts of attribution involving trusts. Accordingly, we shall here critically examine the general recommendation of the CFA as well as the limits that the latter draws to it.

4. The contextual meaning of *'derived by'/'paid to'* and the OECD Partnership Report

A. The general recommendation

1. The principle

As indicated, the OECD Partnership Report discusses various situations in which the Contracting States disagree with respect to the person to whom the partnership income is to be assigned for tax purposes. In essence, the CFA submits that these divergences may be resolved if, when applying the relevant distributive rule, the source country relies on the attribution principles of the residence state. Specifically, according to the Report the source state should consider that an item of income is 'derived by'/'paid to' a resident of the other Contracting State if this jurisdiction allocates this item to the person claiming treaty benefits as a resident. The 2000 update of the OECD Commentary now provides as follows:

> '. . . the State of source should take into account, as part of the factual context in which the Convention is to be applied, the way in which an item of income, arising in its jurisdiction, is treated in the jurisdiction of the person claiming the benefits of the Convention as a resident.'[58]

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53 OECD Commentary, para. 2 and Art. 23A and 23B.

54 Lang, n. 21 above, pp. 29, 56 and example 4, p. 58 and example 5.

55 See OECD Commentary, para. 41 and Art. 10 of OECD MC.

56 Doernberg and Van Raad, *Hybrid Entities and the US Model*, p. 757.

57 Danon and Salome, n. 3 above, p. 393.

58 OECD Commentary, para. 6.3 and Art. 1 of OECD MC, 2000 addition in accordance with the OECD Partnership report, p. 54.

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As observed by Sasseville[59] and Loukota,[60] the principles proposed by the OECD Partnership Report are fairly close to the solution adopted by the 1996 US MC[61] and the final regulations to IRC 894(c) which, however, do not only apply to partnerships but also to trusts and other similar hybrid entities.

It is the view of the OECD that, in the field of partnerships, the solution advocated by this Report solves double taxation issues stemming from differences in the attribution of income.[62] For example, assuming that the state of source imputes the income to the partnership, whereas the state of residence of the partners and of the partnership treats the latter as transparent, if it were to apply its own attribution rules, the state of source could argue that the treaty does not apply, the partnership not being liable to tax in the state of residence.[63] Hence, in such a case, the CFA maintains that the principle advocated avoids that the income of the partnership on which the partners are liable to tax in their state of residence, be taxed by the state of source regardless of the treaty.[64] As can be seen, these issues are conceptually identical to those we identified in the area of trusts.

Furthermore, the CFA relies on the same analysis in order to determine treaty benefits in situations where three states are involved (triangular cases).[65] That is, where a partnership is established in one jurisdiction whereas the partner resides in another country and the latter derives income from a third state, then the partner would be able to claim the benefits of the treaty between his state of residence and this third country, provided that his state of residence fiscally allocates the partnership's income to him.[66] By contrast, if the income is attributed to the partnership by the state in which it is organized, then the source state should apply its treaty with this jurisdiction.[67] Finally, where both the residence sate of the partner and that of the partnership exercise taxing jurisdiction over the same item of income, then the treaty of the source state with both these countries potentially become applicable (double benefits). As a result, the source state would not be able to impose taxation that is inconsistent with the terms of either applicable treaty. Accordingly, if different rates are provided for in the two treaties, the lower one would be applied.[68] Again, one will recognize the similarities with the triangular situations we discussed.

Conversely, from the perspective of the state of residence, the CFA takes the view that this country should give this person a credit for the tax levied by the source state, albeit on a different taxpayer under its internal law.[69]

2. *Critical analysis*

As to its contextual justification, it must be admitted that the general recommendation of the OECD Partnership Report serves much more efficiently the object and purpose of the distributive rules than a *lex fori* approach.[70] That is, by demanding that the source country construe the expression 'derived by'/'paid to' by taking into account the attribution rules of the residence state, this solution allows both Contracting States to achieve a common interpretation of the treaty (*Entscheidungsharmonie*[71]), which results in an unam-

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59 Jacques Sasseville, 'OECD Releases Report on Application of Model Treaty to Partnerships' in Tax Notes Int'l 1999, p. 623.

60 Helmut Loukota, 'Der OECD-Report zur Anwendung des OECD-Musterabkommens auf Personengesellschaften', in (eds. Gassner et al.), *Personengesellschaften im Recht der Doppelbesteuerungsabkommen, Die Auswirkungen des OECD-Reports auf die Abkommenspraxis*, p. 18.

61 See Art. 4, para. 1, letter d which states that: 'an item of income, profit or gain derived through an entity that is fiscally transparent shall be considered to be derived by a resident of a State to the extent that the item is treated for purposes of the taxation law of such Contracting State as the income, profit or gain of a resident.'

62 OECD Partnership report II.4.52, pp. 21–22; OECD Commentary para. 6.4 and Art. 1 of OECD MC, addition in accordance with the OECD Partnership Report, pp. 53–54. For cases where the partnership is treated as transparent in the state of source and as an entity in the residence state, see OECD Partnership Report II.4.51, p. 21 and example 3 and II.4.64, p. 27 and example 6 in which treaty benefits are denied the partnership not being a resident of the other Contracting State. By contrast, in example 5 the partnership is a resident of the other Contracting State and hence treaty benefits are to be granted by the state of source, see OECD Partnership Report II.4.63, p. 26 and example 5. For cases where the partnership is treated as a taxable entity in the state of source and as transparent in the state of residence, see OECD Commentary para. 6.4 and Art. 1 of OECD MC, 2000 addition in accordance with the OECD Partnership Report, pp. 53–54 and OECD Partnership Report II.4.61, p. 25 and example 4.

63 Pursuant to Art. 4, para. 1 of OECD MC.

64 OECD Partnership Report II.4.60, p. 25 and example 4. Similarly, the principle developed would also prevent double non-taxation cases, where for example the state of source ignores the partnership and imputes the income to the partners, while the state of residence of the partners attributes, on the contrary, the income to a non-resident partnership. See OECD Partnership Report II.4.51, p. 21 and example 3; II.4.64, p. 27 and example 6 and II.4.69 p. 28 and example 7.

65 OECD Commentary, para. 6.5 and Art. 1 of OECD MC, 2000 addition in accordance with the OECD Partnership Report, p. 55.

66 OECD Commentary para. 6.5 and Art. 1 of OECD MC, 2000 addition in accordance with the OECD Partnership Report, p. 55.

67 OECD Partnership Report II.5.71, pp. 29–30 and example 8.

68 OECD Commentary para. 6.5 and Art. 1 of OECD MC, 2000 addition in accordance with the OECD Partnership Report, p. 55; OECD Partnership Report II.5.73, pp. 30–31 and example 9.

69 OECD Partnership Report III.2.139, pp. 50–51 and example 18.

70 In the same vein Daniels, see n. 20 above, p. 159.

71 On this principle see Vogel, n. 2 above, p. 39, no. 74; Reimer, n. 43 above, p. 466; Heinrich and Moritz, n. 7 above, p. 142; Oberson, n. 7 above, p. 26, no. 81; Robert Waldburger, 'Die Auslegung von Doppelbesteuerungsabkommen in der Rechtsprechung des Schweizerischen Bundesgerichts', in M. Lang *et al.* (eds.), *Die Auslegung von Doppelbesteuerungsabkommen* (Vienna, 1998), p. 59; Locher, see n. 43 above, pp. 120–121; Rivier, n. 9 above, pp. 125–126.

biguous allocation of taxing rights, since the income is assigned to the same person.[72] In fact, the principles developed by the OECD Partnership Report are not completely new. Apart from the similar approach already favoured by the US, the advantages of the latter in treaty interpretation have already been convincingly demonstrated.[73]

At the same time, however, the general recommendation of the OECD Partnership Report in the area of divergences in the attribution of income has also been vigorously criticized by several commentators. Furthermore, the Netherlands, for example, has expressed the view that that it will only adhere to the solution advocated by the CFA to the extent it is explicitly confirmed in a specific treaty by virtue of a mutual agreement between the competent authorities or on the basis of unilateral policy.[74] Against this background, we thus find it appropriate to critically analyze the solution proposed by this Report.

(a) The solution proposed and the meaning of the term 'liable to tax'

Among the objections which were raised against the solution proposed by the OECD Partnership Report, it has been argued that the latter is not compatible with the plain language of the term 'liable to tax' contained in the residence Article (Art. 4, para. 1 of OECD MC). Specifically, Lang maintains that by demanding that the income arising in the source state be fiscally allocated by the other Contracting State to one of its residents, the solution of the report comes close to a 'subject-to-tax' clause. Accordingly, this commentator arrives at the conclusion that the interpretation of the CFA contravenes the wording of the expression 'liable to tax'.[75] Moreover, for Lang, the drafters of the OECD Partnership Report ignore that under Art. 4, para.1 of OECD MC it is not relevant if a person is 'liable to tax on the income', but it is sufficient if a person is merely 'liable to tax'.[76] The observation made by Lang, namely that the term 'liable to tax' cannot be construed as a 'subject-to-tax' clause, is indisputably correct. Yet, contrary to this author we do not think that the solution advocated by the CFA amounts to favour such an erroneous interpretation.[77]

First of all, the OECD Partnership Report clearly distinguishes fiscal attribution from effective taxation in the state of residence as it provides that:

> 'a partner is still to be considered liable to tax on the income which "flows through" to him where, in the state of residence, tax is not imposed on that income by virtue of, e.g. a participation exemption in the case of dividends or the application of the exemption method for the relief of double taxation in the case of income attributable to a permanent establishment.'[78]

Secondly, and more important, while it is correct that the term 'liable to tax' of Art. 4 of OECD MC cannot be read as entailing a fiscal allocation of the treaty income, this requirement does not flow from this provision but rather from expressions such as 'paid to'/'derived by'. If one wishes to challenge the reasoning of the CFA, it is thus these terms that must be examined.[79] In our opinion, therefore, the general recommendation of the OECD Partnership Report does not contradict the interpretation of the term 'liable to tax' contained in Art. 4, para. 1 of OECD MC.[80] Furthermore, this recommendation is completely unrelated to this provision.

(b) The solution proposed and the personal scope of the OECD MC

On the contrary, a decisive systematic argument which, in our view, supports the approach favored by the OECD Partnership Report, is the relationship existing between the distributive rules and the personal scope of the OECD MC. Indeed, in accordance with its Art. 1 the OECD MC only applies 'to persons who are residents of one or more or both of the Contracting States'. As we are dealing here with a tax treaty, it seems logical to draw the conclusion that this principle implies that the OECD MC is only to produce its effect within the limits of the taxing jurisdiction (or fiscal sovereignty) of the Contracting States.[81] It can consequently be maintained that the application of a tax treaty patterned upon the OECD MC requires the item of income covered by the relevant distributive rule to enter into the taxing jurisdiction of the other

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[72] Daniels, n. 20 above, p. 159.

[73] Daniels, n. 20 above, pp. 159 *et seq.*

[74] OECD Commentary para. 27.1 and Art. 1 of OECD MC (observation).

[75] Lang, n. 21 above, p. 37, see also *inter alia p.* 51 and example 3, p. 60 and example 6, p. 63 and example 7.

[76] Lang, n. 21 above, p. 55, example 4.

[77] See Danon and Salome, n. 3 above, p. 396; Salome, n. 17 above, p. 70.

[78] OECD Partnership Report, II.4.53. It is interesting to observe that the IRC 894 final regulations, which endorse the principles of the Partnership Report, also clarify this issue in the same fashion: 'the source state does not necessarily require, as a condition for ceding its taxing jurisdiction, that the income actually be taxed in the residence state or taxed at a rate commensurate with the rate imposed in the source state', IRC, s. 1.894-1 final regulations, supplementary information, IRB, p. 125.

[79] Danon and Salome, n. 3 above, p. 397; Salome, n. 17 above, p. 70.

[80] Danon and Salome, n. 3 above, p. 398.

[81] Danon and Salome, n. 3 above, p. 402.

Contracting State.[82] Under this line of reasoning, one must thus recognize that turning to the attribution rules of the state of residence to ascertain whether this is the case, is the most convincing solution.[83]

Let us however now analyze the exceptional situation, in which according to the CFA, its general recommendation would not apply.

B. The exception: taxation of its own residents by the source state

The CFA takes the view that its general recommendation does not apply to restrict the source state's right to tax its own residents. Specifically, the 2000 update of the OECD Commentary conveys this opinion as follows:

> 'Where a partnership is treated as a resident of a Contracting State, the provisions of the Convention that restrict the other Contracting State's right to tax the partnership on its income do not apply to restrict that other State's right to tax the partners who are its own residents on their share of the income of the partnership.'[84]

Therefore, under this analysis, if for example a partnership derives royalty income from a jurisdiction in which one of its partners also resides, this latter country could rely on its own attribution rules to directly assess this partner as a resident. If one prefers, in such case the source state would not be restricted by Art. 12 of OECD MC on the ground that the state of organization of the partnership does allocate the royalty income to one of its residents.[85] In order to support this line of reasoning, the CFA puts forward that the distributive rules do not affect taxation that is based on residence but only that which is based on source.[86]

This solution contemplated by the CFA is important for our purposes, as in the cases we discussed it could legitimate the unrestricted right of the source state to tax a resident beneficiary (fixed interest trust) of a foreign settlement deriving source income. In our opinion, however, this approach is inconsistent.[87] Indeed, the only reason why the CFA arrives at this result is precisely because, without any sound argument, it suddenly implicitly applies the internal attribution rules of the source state, thereby causing the income to be allocated to one of its residents.

Therefore, as Daniels has suggested, one should here rather consider that the source state must apply the dividends, interest and royalties articles and that it may thus only tax its owns residents at the maximum rate provided by these provisions.[88] In the event the source state does not subject these items to a withholding tax, these distributive rules would then equally limit this country's right to tax its residents by way of an ordinary income tax assessment.[89]

5. Application of the OECD Partnership Report to trusts

A. Case 1: discretionary accumulation trust

1. Facts

T is an irrevocable discretionary accumulation trust resident in a common law jurisdiction, state R, for treaty purposes. In year 1, T derives dividends from a civil law jurisdiction, state S that it decides to accumulate. These dividends are subject to a withholding tax in state S. In year 10, T selects B, a state R resident individual, among a class of potential beneficiaries and distributes to him an amount equaling the dividends.

As is the case in several common law jurisdictions, under the laws of state R the accumulated trust income derived in year 1 is attributed (and taxed) to T. In order to avoid economic double taxation of trust income, state R treats the subsequent distribution to B as a tax-exempt capital transfer.

The concept of trust, on the contrary, is alien to state S legal and tax system. As a result, state S does not treat T as a separate taxpayer and does not allocate trust income to the latter. Rather, under the laws of state S, the only person to whom the income could potentially be fiscally allocated is B who is, however, unknown in year 1. Accordingly, from the perspective of state S, an

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82 *Ibid.*

83 *Ibid.*

84 OECD Commentary para. 6.1, Art. 1 of OECD MC, 2000 addition in accordance with the OECD Partnership Report, p. 54. See also OECD Partnership Report example 16, p. 46 *et seq*. For an analysis of this example Hans-Jörgen Aigner and Mario Züger, 'Abkommensvergünstigungen für im Quellenstaatansässige Gesellschafter von Personengesellschaften?' in SWI 2000, p. 308 *et seq*.

85 Interestingly the OECD Partnership Report (III.2.126 pp. 46–47) indicates that some delegates still considered that Art. 12 of OECD MC should equally restrict the source state's taxing rights in such case.

86 OECD Partnership Report III.2.127, p. 47.

87 Danon and Salome, n. 3 above, p. 404. In the same vein as regards the inconsistency of the Report on this point, Lang, n. 21 above, p. 92, example 16, who rejects this reasoning and proposes another approach; Murray Clayson, 'OECD Partnership Report: Reshaping Treaty Interpretation?', in BTR 2000, p. 81; Salome, n. 17 above, pp. 74 *et seq*.

88 Daniels, n. 20 above, p. 167.

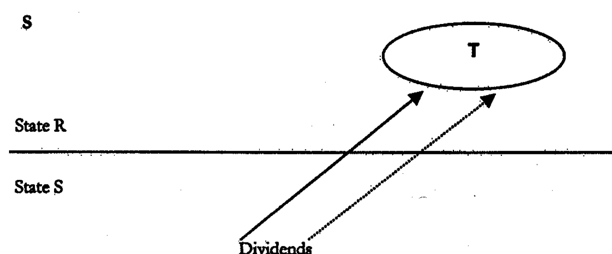
89 Daniels, n. 20 above, p. 167.

attribution of income in the hands of a recipient of state R would only take place in year 10 that is when the trustee's discretion is exercised in favour of B.

The S-R treaty is patterned upon the OECD MC.

2. Analysis

Pursuant to the general recommendation of the OECD Partnership Report, state S would here interpret the words 'paid to'/'derived by' by reference to the attributions rules of state R. Accordingly, because state R would allocate the state S source income to T, one of its residents, state S would reduce its withholding to the appropriate treaty rate. In turn, state R would provide double taxation relief, as the item would be taxed by state S in accordance with the S-R treaty.



Some commentators have also arrived at the same conclusion but by considering that an accumulation trust/trustee should be regarded as the 'beneficial owner' of the income.[90] While there are very good reasons to consider that the trust/trustee is in this particular situation also the beneficial owner of the income,[91] from a systematic point of view, however, this argument is not correct. Indeed, one should first determine whether the relevant item of income has been attributed to a resident by interpreting the term 'paid to'/'derived by' which, under the proposed solution, involves checking whether state R allocates the item to one of its residents. If this is the case, it is then possible to move to the 'beneficial ownership' requirement and examine if, taking into account the contextual meaning of the term in light of its object and purpose, the fiscal recipient of the income is also the beneficial owner for treaty purposes.

B. Case 2: grantor trust with a state S resident beneficiary

1. Facts

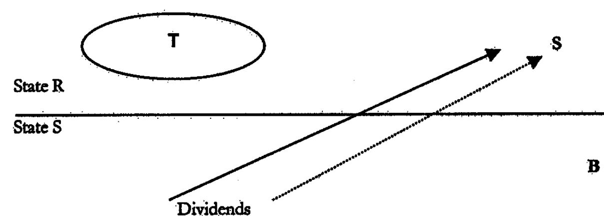
T is a revocable fixed interest trust established under the laws of state R. The settlor of T, S, is a state R resident individual. Under the settlement, S holds a power to revoke that triggers the state R grantor trust rules. The beneficiary of T, B, holds a vested estate for life and therefore is entitled to receive all periodical income derived by T. B is a state S resident individual. In 2003, T derives dividends, interest and royalties from sState S.

In accordance with so-called 'grantor trusts' rules, state R attributes the income derived by T to S. For state S, on the contrary, the income derived by T is attributable to B. Indeed, state S solely relies on the fact that B here acquires a vested interest under trust law.

The S-R treaty is patterned upon the OECD MC.

2. Analysis

Departing from the exception provided by the OECD Partnership Report, we here take the view that state S should equally apply its treaty with state R, notwithstanding the fact that the person deriving the income directly under the laws of state S is B, a resident. As explained above, under this analysis, state S would still be able to assess the income received by such beneficiary, but by complying with the limitations imposed by the dividends, interest and royalties Articles of the S-R treaty.



C. Case 3: triangular case involving a grantor trust

1. Facts

T is a revocable fixed interest trust established under the laws of state R. The settlor of T, S, is a state SR resident individual. Under the settlement, S holds a power to revoke that triggers the state SR grantor trust rules. The beneficiary of T, B, holds a vested estate for life and therefore is entitled to receive all periodical income derived by T. B is a state B resident individual. In 2003, T derives dividends, interest and royalties from state S.

In accordance with so-called 'grantor trusts' rules, state SR attributes the income derived by T to S. For

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[90] Walter Ryser, 'Trusts and double taxation treaties concluded by Switzerland', in *Archiv für Schweizerisches Abgaberecht (Archives de Droit Fiscal Suisse)* (Bern, Switzerland), p. 315. In the same vein J.F. Avery Jones *et al.*, 'The Treatment of Trusts under the OECD Model Convention', in ET 1989, p. 393.

[91] See Danon, thesis, p. 343.

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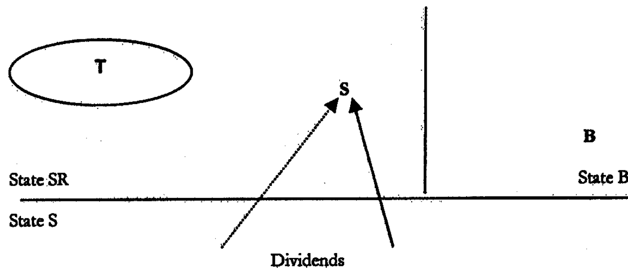
state S, on the contrary, the income derived by T is attributable to B. Indeed, state S solely relies on the fact that B here acquires a vested interest under trust law.

2. *Analysis*

Since state SR would here allocate the state S source income to one of its residents, state S would apply its treaty with state SR, which would in turn eliminate double taxation.



If, in addition, state B allocates the income to B as well and state S has also concluded a treaty with this jurisdiction, then state S would comply with its obligations under both treaties by imposing the lower rate.

6. Conclusion

In light of the foregoing considerations, we arrive at the following conclusions.

The general recommendation proposed by the OECD Partnership Report and 2000 Commentary in order to resolve conflicts of attribution in the field of partnerships, codifies the appropriate contextual interpretation of the term 'paid to'/'derived by' contained in the distributive rules. We thus see no reason why this recommendation could not come into play with respect to conflicts of attribution involving other vehicles, such as trusts. By contrast, the exception to which the OECD Partnership refers (taxation of its own residents by the state of source) should be rejected on the ground of inconsistency.

More generally, the difficulties created by conflicts of attribution illustrate that the time has passed where two Contracting States used to have identical attribution principles. In this context, the concept of international double taxation contained in the OECD Commentary should preferably be refined so as to focus more on the allocation of taxing claims between the parties and on their exercise of taxing jurisdiction over the latter, rather than on the so-called 'identity of subject' requirement inherent to juridical double taxation. As a matter of fact, by tackling conflicts of attribution relating to partnerships the OECD has already implicitly recognized that, in source-residence situations, the application of the distributive rules cannot be conditional on both states allocating the treaty favoured income to the same taxpayer.

Finally, let us bear in mind that the application of tax treaties to trusts raises other difficulties which we have not discussed in this contribution. For example, the question arises as to whether, and if so under which conditions, a party to a trust relationship can be regarded as *the beneficial owner* of the income derived from the source state.[92]

Notes

[92] For an analysis of the application of the beneficial ownership requirement to trusts, see Danon, thesis, pp. 326–350.