ARTICLE

Redefining the Relation Between Articles 6, 7 and 21 of the OECD Model

Alexander Bosman*

The relation between the Articles 6, 7 and 21 of the OECD Model Tax Convention (OECD Model), and in particular the scope of the exception for immovable property in Article 21(2), has been widely debated in academic literature. The approach proposed in this article gives the immovable property exception a proper role, thus defining the relation between the Articles 6, 7 and 21 of the OECD Model in e.g. triangular cases involving immovable property of an enterprise. In the case of immovable property of an enterprise that is situated in the residence state (State R) or in a third state (State T) and that is attributable to a permanent establishment (PE) in the other contracting state (State S), the author takes the view that the 'context' within the meaning of Article 3(2) of the R-S tax treaty prevents State S from categorizing the income under Article 7, regardless of its domestic law classification of the income as business profits. This context consists, inter alia, of Article 21(2) of the R-S tax treaty. Consequently, Article 21(1) of the R-S tax treaty must be applied in respect of the income from the immovable property located in State R or in State T, assigning the exclusive taxation right under this treaty to State R. To reinforce the proposed approach, the author recommends adding language to the OECD Commentary on Article 21 which confirms the inapplicability of Article 7 to income from immovable property situated in State R or State T. Regardless of the proposed changes to the OECD Commentary, the author believes that the effectiveness of the exclusion of immovable property from the scope of Article 21(2) could be further improved by amending Article 21 as suggested.

1 Introduction

Article 21 of the OECD Model Tax Convention (the OECD Model) contains the general distributive rule for items of income that are not dealt with in the preceding articles, i.e., the Articles 6 through 20. Under Article 21(1), the exclusive right to tax such items of income is assigned to the state of residence of the recipient of the income. The article applies to types of income which are not dealt with in the preceding articles (i.e. income which by its nature cannot be categorized under the other rules), as well as income falling outside the geographical scope of the preceding rules (i.e. income which may be of a category dealt with in a previous rule, but which is not covered by that article because it does not account for income arising in third states or in the residence state).[1] Therefore, Article 21(1) of the OECD Model in principle covers all income not dealt with by the other distributive rules.

Article 21(2), which is an exception to the main rule of Article 21(1), contains a rule for 'other income' that is associated with a permanent establishment (PE). Article 21(2) deals with the situation that the recipient of the 'other income' has a PE in the other contracting state, and the right or property in respect of which the income is paid is effectively connected with this PE. In that case, Article 7 applies and thus the PE state has the authority to tax the 'other income'. However, Article 21(2) excludes from its scope income from immovable property as defined in Article 6(2). The significance of the second paragraph of Article 21, as well as the scope of the exclusion for immovable property in that paragraph, is subject to different views. This concerns especially the case of immovable property of an enterprise that is situated in the enterprise's residence state or in a third state and that is attributable to a PE in the other contracting state. In this article, the author gives his opinion on the meaning of the exception for immovable property in Article 21(2).[2] The approach proposed in this article gives the immovable property exception of Article 21(2) a proper role by employing Article 3(2), thus defining the relation between the Articles 6, 7 and 21 of the OECD Model in triangular cases involving immovable property of an enterprise.

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1 OECD Commentary on Art. 21, para. 1.

2 This article is based on parts of the author's PhD thesis; R.A. Bosman, Other Income Under Tax Treaties, Series on International Taxation no. 55 (Alphen aan den Rijn: Kluwer Law International 2015). This dissertation provides a comprehensive analysis of Art. 21 of the OECD Model.

First, section 2 contains some brief general comments on Article 21(2), leaving aside the immovable property exception. Section 3 discusses the scope of the immovable property exception in Article 21(2) in relation to immovable property falling outside the geographical scope of Article 6, and the author's proposed approach. The author's suggested amendment of Article 21 is described in section 4, followed by the author's conclusions (section 5).

2 General comments on article 21(2)

The terms 'right' and 'property' used in Article 21(2) are not defined in the OECD Model and should in principle be interpreted with the aid of Article 3(2), the general interpretive clause, which means that these terms have the meaning according to the laws of the states applying the treaty, unless the context otherwise requires.[3] Although these terms are very broad, and are likely to encompass all types of tangible and intangible assets or rights thereto, Article 21(2) is particularly relevant in respect of dividends, interest and royalties falling outside the bilateral scope of the Articles 10, 11 and 12 of the OECD Model. The OECD Commentary supports the position that Article 21(2) covers income from the residence state, as well as income from third states that can be attributed to a PE in the other contracting state.[4] Because all profits from an enterprise of a contracting state, whether or not derived through a PE, are already dealt with by Article 7, including income arising in the residence state and in third states, it can be questioned whether Article 21(2) has an independent meaning. According to the author, Article 7 covers all business profits, comprising dividends, interest and royalties falling outside the geographical scope of the Articles 10, 11 and 12 of the OECD Model. This concerns dividends, interest and royalties arising in the residence state and in third states. Article 7(4) provides that where profits are dealt with separately in other distributive rules, these provisions take priority over Article 7. With regard to income from the residence state or from third states, Article 21(2) does not come into play. Because the Articles 10, 11 and 12 are inapplicable due to their bilateral reach, Article 7 continues to be applicable. Therefore, the right to tax is assigned to the PE state on the basis of Article 7(1), second sentence.[5] Article 21(2) merely confirms this result, but has no independent meaning.[6] The author is of the opinion that Article 21(2) merely has a clarifying function as regards these types of income.[7]

However, Article 21(2) is not completely without stand-alone significance. An important exception must be made for states that do not tax all items of income of a company as business profits. This mainly concerns certain common law countries, such as the UK. If income attributable to a PE is not taxed, per se, as business profits under the domestic tax law of the PE state, for instance in the case of a state with a schedular tax system like the UK, the income is not characterized as 'business profits' within the meaning of Article 7.[8] The income concerned falls within the scope of Article 21(1), and the application of Article 21(2) redirects the income to Article 7, provided the assets or rights in respect of which the income is paid are effectively connected to the PE.[9]

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[3] Where necessary, Art. 3(2) is complemented by the rules of the Vienna Convention on the Law of Treaties (VCLT). Art. 3(2) cannot be applied if the undefined treaty term at issue is not defined in domestic tax law (e.g. the Dutch *Hoge Raad* decisions of 1 Dec. 2006, *BNB* 2007/75-79) or if it does not have a specific legal meaning (e.g. the *Hoge Raad* decisions of 28 Sept. 1999, *BNB* 2000/16 and 29 Sept. 1999, *BNB* 2000/17). Moreover, the Dutch *Hoge Raad* ruled that Art. 3(2) cannot be applied to interpret a term that is not used in a similar context under the domestic law *(Hoge Raad* decisions of 21 Feb. 2003, *BNB* 2003/177 and 178). In these cases, Arts 31 through 33 of the VCLT govern the interpretation of the treaty term at issue.

[4] OECD Commentary on Art. 21, paras 4 and 5. *See also* the OECD Commentary on Art. 23 A and 23 B, para. 10.

[5] Compare the German *Bundesfinanzhof* decision of 12 June 2013, no. I R 47/12, IBFD Tax Treaty Case Law, in which the *Bundesfinanzhof* categorized interest paid by a resident of a third state that was attributable to a PE in Germany under Art. 7(1) of the 1967 Germany-Thailand tax treaty. Because the tax treaty in question lacked a provision similar to Art. 21 of the OECD Model, the *Bundesfinanzhof* did not comment on the significance of Art. 21(2) of the OECD Model.

[6] *See* Bosman, *supra* n. 2, at 226, and the literature cited there.

[7] For a different view, *see*, e.g. A. Rust, *Situs Principle v. Permanent Establishment Principle in International Tax Law*, 56(1) Bull. Intl. Taxn. 15, 17 (2002); A. Rust, *Other Income (Article 21 OECD Model Convention)*, in *Source Versus Residence* 330–332 (Lang, Pistone, Schuch, Staringer eds, Alphen aan den Rijn: Kluwer Law International 2008); T. Seitz, *The Relationship Between Art. 7 and Art. 21 OECD Model Convention*, in *Permanent Establishments in International and EU Tax Law* 269 et seq. (F. Brugger & P. Plansky eds, Vienna: Linde 2011); A. Rust, *Article 21. Other Income*, in *Klaus Vogel on Double Taxation Conventions* 1556 (E. Reimer and A. Rust eds, 4th ed., Alphen aan den Rijn: Kluwer Law International 2015).

[8] *See* J.F. Avery Jones, *Does Any Income Fall Within Article 21(2) of the OECD Model?*, in *A Tax Globalist, Essays in Honour of Maarten J. Ellis* 1–11 (H. van Arendonk, F. Engelen & S. Jansen eds, Amsterdam: IBFD 2005). Although Avery Jones agrees to the logic of this reasoning, he reaches a different conclusion from a UK perspective. Under the UK's domestic tax system, which has a schedular income tax, the profits of an enterprise are not comprehensively taxed as 'business profits', but various types of income of a corporation are taxed under various schedules. There is no schedule for business income. Also if a foreign enterprise has a PE in the UK, for instance 'trade income', dividends, interest and capital gains are taxed under separate schedules. Dividends, interest and royalties which can be allocated to a PE in the UK are therefore not 'business profits' within the meaning of Art. 7 for purposes of treaty application by the UK (as a result of Art. 3(2)). Therefore, the classification of dividends, interest and royalties that can be allocated to a PE starts with the Arts 10, 11 and 12. This also applies to dividends, interest and royalties that can be allocated to a PE in the UK. These items of income art not dealt with in the preceding articles within the meaning of Art. 21(2), particularly not in Art. 7. Art. 21(2) subsequently refers the income to Art. 7, which would otherwise not have applied. For purposes of treaty application by the UK, Art. 21(2) therefore does have an independent meaning. *See also* J.F. Avery Jones et al., *Treaty Conflicts in Categorizing Income as Business Profits Caused by Differences in Approach Between Common Law and Civil Law*, 57(6) Bull. Intl. Taxn. 237, 245, n. 56 (2003).

[9] Cf. E. Fett, *Triangular Cases* 26 et seq. (Amsterdam: IBFD 2014).

3 PE-related income from immovable property not within the geographical scope of article 6

3.1 *Introduction*

Since Article 6 applies to income derived by a resident of a contracting state from immovable property situated in the other contracting state, the article has a bilateral scope. Consequently, income from immovable property situated in the state of residence or in a third state does not fall within the ambit of this provision.[10] This is supported by the OECD Commentary, which explains that Article 6 does not apply to income from immovable property that is situated in the state of residence of the recipient of the income or in a third state. According to the Commentary, the provision of Article 21(1) shall apply to these types of situations.[11] However, if the residence state treats the income as business profits, the income is governed by Article 7(1). In the absence of a PE in the other contracting state, the application of Article 7 has the same result, i.e. exclusive residence state taxation.[12] The interaction between Articles 6, 7 and 21 becomes more complex, though, in cases where income from such immovable property is derived through a PE in one of the contracting states.

This article distinguishes the following situations in which immovable property of an enterprise is attributable to a PE[13]:

(1) Immovable property owned by an enterprise residing in a contracting state (State R) is located in the that same state and it can be attributed to a PE in the other contracting state (State S); see Figure 1 below[14];

(2) Immovable property owned by an enterprise residing in State R is located in a third state (State T) and it can be attributed to a PE in State S; see Figure 2 below.[15]

Figure 1 Immovable property in State R; PE in State S

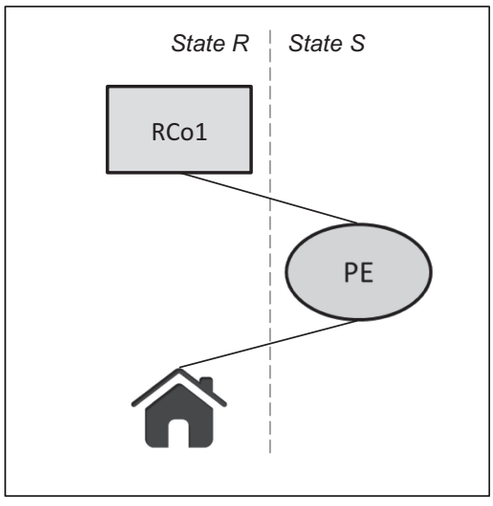
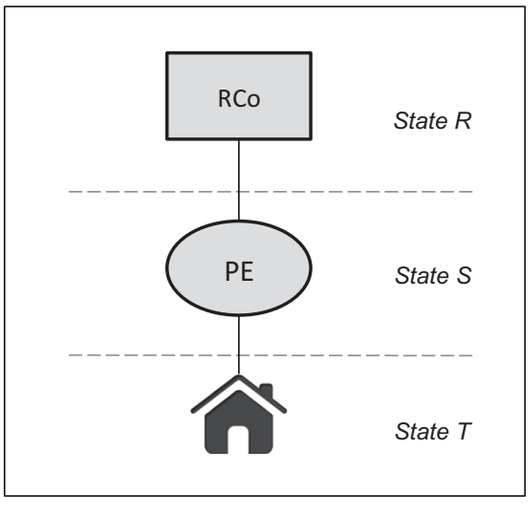


Figure 2 Immovable property in State T; PE in State S



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[10] D.A. Ward et al., *The Other Income Article of Income Tax Treaties*, 11 Brit. Tax Rev. 352, 361, n. 26, and 364 (1990). According to these authors, this conclusion is confirmed by the reference to income from immovable property in para. 2 of the 'other income' article (364, n. 47). This position is not further explained. Reference is made to ss 3.3.1 and 3.4.1 for the author's views concerning the relevance of the exception for immovable property in Art. 21(2) in respect of income from immovable property located in the residence state or in a third state.

[11] OECD Commentary on Art. 6, para. 1.

[12] Art. 6(1) in the 1963 version of the OECD Model provided that '[i]ncome from immovable property may be taxed in the Contracting State in which such property is situated'. Therefore, the article also applied to income from immovable property situated in the state of residence of the recipient of the income. In these circumstances, Art. 21(1) does not play a role as a residual clause. However, application of Art. 6 would not lead to a different conclusion: the right to tax would be assigned primarily to the situs state, coinciding with the residence state. In such case, the immovable property article applies also to income derived from immovable property located in the residence state. In the 1977 version of the OECD Model, the scope of Art. 6 was limited to immovable property situated in the other contracting state.

[13] This article does not discuss the case where a resident of a contracting state (State R) owns immovable property that is located in the other contracting state (State S) and which can be attributed to a PE in that same State S. In that case, either Art. 6 of the R-S tax treaty, which allocates the right to tax income from the immovable property to State S, the situs state, is applicable, or Art. 7 of the R-S tax treaty is applicable, which also results in the income from the immovable property being taxable in the PE state/situs state.

[14] It is assumed that the tax treaty between State R and State S is patterned on the OECD Model.

[15] It is assumed that tax treaties patterned on the OECD Model are in place between all states.

3.2 *Treaty Application by the PE State*

Where immovable property of an enterprise of State R is located in State R or in State T, but is attributable to a PE in State S, two lines of reasoning are possible:

(1) Article 7 of the R-S tax treaty, which allocates the primary right to tax income from the immovable property to State S, is applicable; or

(2) Article 21(1) of the R-S tax treaty, which allocates the exclusive right to tax income from the immovable property to State R, is applicable, possibly by virtue of the exclusion of immovable property in Article 21(2).

The OECD Commentary supports the view that Article 21 of the R-S tax treaty governs income from immovable property situated in State R and forming part of the business assets of a PE in State S. This case is discussed in paragraph 4 of the OECD Commentary on Article 21(2):

> *Paragraph 2 {of Article 21} does not apply to immovable property for which, according to paragraph 4 of Article 6, the State of situs has a primary right to tax (cf. paragraphs 3 and 4 of the Commentary on Article 6). Therefore, immovable property situated in a Contracting State and forming part of the business property of a permanent establishment of an enterprise of that State situated in the other Contracting State shall be taxable only in the first-mentioned State in which the property is situated and of which the recipient of the income is a resident. This is in consistency with the rules laid down in Articles 13 and 22 in respect of immovable property since paragraph 2 of those Articles applies only to movable property of a permanent establishment.*

See also paragraph 9 of the OECD Commentary on Articles 23 A and 23 B, the relevant part of which reads as follows:

> *Where a resident of the Contracting State R derives income from the same State R through a permanent establishment which he has in the other Contracting State E, State E may tax such income (except income from immovable property situated in State R) if it is attributable to the said permanent establishment (paragraph 2 of Article 21).*

There is also some support in the OECD Commentaries that Article 21(1) applies when income from immovable property situated in State T is concerned. See paragraph 10 of the OECD Commentary on Articles 23 A and B, which reads in relevant part[16]:

> *Where a resident of State R derives income from a third State through a permanent establishment which he has in State E, such State E may tax such income (except income from immovable property situated in the third State) if it is attributable to such permanent establishment (paragraph 2 of Article 21).*

According to the OECD Commentary, the income from the immovable property is taxable only in the state where the immovable property is situated, i.e. State R rather than State S. This conclusion would conform to the situs principle that underlies the allocation of the right to tax income from immovable property. It is apparently based upon the reasoning that, as a result of the exclusion for immovable property in Article 21(2) of the OECD Model, Article 21(1) continues to be applicable to income from immovable property in State R and State T. The conclusion would be that State S is not allowed to tax the income. In the author's view, it must be doubted whether this conclusion is correct.

First of all, when discussing immovable property situated in State R, the OECD Commentary refers to Article 6(4). However, Article 6 is not applicable in this case because it applies only to income derived by a resident of a contracting state from immovable property situated in the other contracting state. Income from immovable property which is situated in State R therefore does not come within the ambit of this provision.

If State S were to apply Article 7 of the R-S tax treaty, it would tax the PE income (including the income from immovable property located in State R or State T), whereas the application of Article 21(1) of the R-S tax treaty would grant the exclusive right to tax the income from the immovable property to the residence state. Article 7(4) provides that where profits include items of income which are dealt with separately in other articles of the treaty, the provisions of those articles shall not be affected by Article 7. If income is covered by another distributive rule, the other article therefore takes precedence over Article 7. However, because Article 6 of the R-S tax treaty does not apply to income from immovable property in State R or State T, Article 7 is applicable from the outset. Thus, the article applied by the PE state (State S) depends on treaty interpretation and on the scope of the business profits concept in the domestic law of State S. If that state applies Article 3(2) of the R-S tax treaty to interpret the term 'business profits', and the concept of business profits in its domestic law includes income from immovable property, regardless of where that property is situated, the income in question is classified under Article 7, rather than Article 21 of the R-S tax treaty. As a result, State S may in that case tax the profits that are attributable to the PE pursuant to Article 7(1). In the author's view, however, the 'context' requires a different interpretation, deviating from the domestic law concept of business profits. The author submits an approach to deal with these cases, which attaches significance to the exclusion for immovable property in Article 21(2); see sections 3.3.1 and 3.4.1 below.

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[16] In 2010, a sentence was added to para. 74 of the Commentary on Art. 7 to repeat these conclusions.

Alternatively, the income from immovable property attributable to a PE may not be regarded as business profits under the domestic tax law of the PE state, for instance in case of treaty interpretation by a state with a schedular tax system.[17] Income from immovable property located in State R or in State S that is not treated as business profits under the domestic law of State S does not fall under within the scope of Article 7 from the start. In that case, Article 21(1) applies to the income, and the exclusion of immovable property in Article 21(2) affirms this outcome by removing the income from the referral to Article 7. Article 21(1) assigns the exclusive taxation right to State R, so that State S is not allowed to tax the income from immovable property situated in State R or in State T.

3.3 *Immovable Property in State R*

3.3.1 *Proposed Approach*

A consequence of the application of Article 7 – supposing that this article applies as a starting point – is that the exclusion of immovable property in Article 21(2) is meaningless when the immovable property is located in the residence state, because Article 21(1) is not applicable in the first place.[18] Moreover, the result of the application of Article 7, i.e. taxation in State S, is opposite to that of Article 21(1), which would continue to apply if Article 21 (2) were applicable. The following interpretation attaches significance to the exclusion of immovable property in Article 21(2). In the author's view, it can be argued that in the example depicted in Figure 1, the 'context' within the meaning of Article 3(2) of the R-S tax treaty dictates that State S cannot apply Article 7, regardless of its domestic law classification of the income as business profits. The context for this purpose consists of Article 21(2) of the R-S tax treaty, which indicates – through the exclusion of immovable property – the implied objective of the OECD Model that income from immovable property situated in State R ought to be taxed exclusively in State R. Moreover, the OECD Commentary on Article 21 (2) cited in section 3.2 above is relevant context. The same can be said of the OECD Commentary on Article 23 A and 23 B. These Commentaries further support the conclusion that State S should not be allowed to tax the income from the immovable property located in State R. This contextual interpretation prevents State S from characterizing income from immovable property located in State R as business profits under Article 7. Consequently, Article 21(1) of the R-S tax treaty has to be applied in respect of the income from the immovable property in State R, assigning the exclusive taxation right to State R.[19]

The suggested approach is in line with the situs principle, i.e. taxation of the immovable property in the state where the property is situated. Furthermore, the proposed approach results in a parallel outcome for both income from immovable property situated in State R and capital gains from the alienation of such immovable property.[20]

Article 21(2) refers to 'income from immovable property as defined in paragraph 2 of Article 6'. Article 6(2), in its turn, refers to the domestic law of the contracting state where the property is situated. In the example discussed here, Article 6(2) thus prescribes a *renvoi* to the definition of immovable property in accordance with the domestic law of State R. This means that if State S, when applying its own domestic law definition, would not consider the property in State R to be immovable, it would be required to accept the qualification of the property as immovable under State R's domestic law. As a result, State S would be bound by State R's characterization of the property as immovable. However, in the author's view the dependency on the domestic law of State R would not be unrestricted. The application and interpretation of the R-S tax treaty is generally governed by the principle of good faith (Articles 26 and 31(1) of the Vienna Convention on the Law of Treaties; VCLT). Consequently, the good faith principle may restrict the priority of State R's domestic law definition of immovable property. For example, the good faith principle may prevent State R from unilaterally expanding its taxation rights under the relevant tax treaty by broadening the scope of its domestic law concept of immovable property, and thus the scope of Article 6(2), to such an extent that items of income are shifted from another distributive rule (under which State R would not be entitled to tax the income, or only to a lesser extent) to Article 6 (under which State R would have the primary right to tax).

In case the R-S tax treaty does not contain a provision similar to Article 21(2), the proposed approach cannot be applied, because there is no context preventing State S from characterising income from immovable property located in State R as business profits under Article 7. As a result, State S may in that case tax the profits that are

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[17] Cf. Jones, *supra* n. 8, 1–11.

[18] Rust (2002), *supra* n. 7, at 17.

[19] However, if the income from the immovable property is not taxed as business profits under the domestic tax law of State S, then Art. 7 does not apply from the outset. In that event, the provision to be applied is Art. 21(1) of the R-S tax treaty, and the exclusion of income from immovable property in Art. 21(2) confirms this classification by carving out the income from the *renvoi* to Art. 7.

[20] Both Art. 13(1) and Art. 13(2) of the R-S tax treaty are inapplicable in respect of a gain on the alienation of immovable property owned by a resident of a State R that is located in that same state and that can be attributed to a PE in State S. Consequently, Art. 13(5) of the R-S tax treaty assigns the exclusive right to tax gains from the alienation of the immovable property to State R, preventing State S from taxing these gains.

attributable to that PE, including income from immovable property in State R, pursuant to Article 7(1).

The author acknowledges that the contextual approach set out above may not be followed in practice. As a result, the exclusion of immovable property in Article 21(2) may not have the effect of preventing State S from taxing income from the immovable property under Article 7. In the author's view, an amendment of the OECD Commentary may further contribute to the intended effect. The author recommends that the reference to Article 6(4) in paragraph 4 of the OECD Commentary on Article 21 is deleted in favour of an explicit confirmation in the OECD Commentary on Article 21 that Article 7 does not deal with income from immovable property situated in the taxpayer's state of residence.[21] Notwithstanding this recommendation, an amendment of Article 21 would even better ensure that immovable property situated in the residence state is not taxed in the PE state (see section 4).

3.3.2 *Alternative Solutions*

There seems to be agreement among academic scholars that the application of Article 7 to income from immovable property that is situated in State R and attributable to a PE in State S is not desirable, although it is possibly inevitable in certain circumstances. The line of reasoning to support the application of Article 21(1) of the R-S tax treaty in these circumstances varies. According to some authors, the immovable property exception of Article 21 (2) results directly in the application of Article 21(1).[22] Others argue that the situs principle or the scope of Article 6 prevents the application of Article 7.[23] Yet another position – brought forward notably by Rust – is that the income is removed from the scope of Article 7 on the basis of Article 7(4) of the OECD Model.[24] As explained in section 3.2, the present author is not convinced that the various suggested approaches effectively prevent State S from taxing the income from immovable property as part of the PE profits.

When the contextual approach defended by the author in section 3.3.1 is not followed, double taxation could arise if State S taxes the income from the immovable property situated in State R under Article 7 of the R-S tax treaty, while State R takes the view that Article 21(1) of the R-S tax treaty applies.[25] Accordingly, State R will not grant relief from double taxation if it takes the position that State S has not taxed the income 'in accordance with the convention', since State S has imposed its tax based on an incorrect interpretation of the treaty.[26] An alternative solution to address this double taxation could

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[21] *See* Bosman, *supra* n. 2, at 535 et seq. for the author's suggested mark-up of the current Commentary.

[22] B.J. Arnold, *At Sixes and Sevens: The Relationship Between the Taxation of Business Profits and Income from Immovable Property Under Tax Treaties*, 60(1) Bull. Intl. Taxn. 5, 12 (2006), is of the opinion that income from immovable property located in the residence state falls within Art. 21(1) due to the operation of the immovable property exception of Art. 21(2). Similarly, Fett, *supra* n. 9, at 47, n. 77, takes the position that the exception for immovable property in Art. 21(2) applies in case income from immovable property situated in the residence state is attributable to a PE in the other contracting state, in which case Art. 21(1) continues to be applicable. Rust (2015), *supra* n. 7, at 1556, takes a similar position based on the supposed independent function of Art. 21(2), which arguably follows from the context provided by, *inter alia*, the OECD Commentary on Art. 21. Compare J. Sasseville & R. Vann, *Article 7: Business Profits*, Global Tax Treaty Commentaries, s. 6.1.2 (IBFD), who refer to the clear indication that income from immovable property that is not located in the PE state should not be taxable there. Yet another approach is suggested by N. Saccardo, *Chapter 6: Income from Immovable Property of an Enterprise in Triangular Cases: The Relationship Between Articles 6, 7 and 21 of the OECD Model*', in *Immovable Property Under Domestic Laws, EU Law and Tax Treaties*, IBFD Online Books, s. 6.3.2 (G. Maisto ed., IBFD 2015), who argues that the exception for immovable property in Art. 21(2) provides for an additional and independent distributive rule, granting the taxation right to State R by referring the income to Art. 21(1), irrespective of domestic business profit concepts and the situs of the immovable property. In case of income from immovable property situated in State R which is classified as business profits by State S, an overlap occurs between Art. 7 and Art. 21(2), which is resolved in favour of Art. 21(2) by Art. 7(4). In the present author's view, the application of Art. 21(1) does not follow directly from Art. 21(2), although this provision is relevant for purposes of the proposed contextual interpretation.

[23] According to Ward et al., *supra* n. 10, at 374, n. 94, income from immovable property situated in the state of residence is 'other income', even if the immovable property is effectively connected with the PE in the other state. This conclusion is based on the observation that Art. 6 does not refer to immovable property being effectively connected with a PE. As a result, according to these authors, Art. 7 cannot be applicable to income from immovable property situated in the situs state, and income from immovable property in the residence state is classified under Art. 21, even if the income is effectively connected with a PE in the other contracting state. These authors note, however, that if the other state, by applying Art. 3(2) and the meaning of business profits in its internal law, characterizes income from immovable property as business profits, such income might fall under the business profits article. According to these authors, in this respect the 'context' of the treaty is not as strong in displacing the domestic law characterization as may be the case when other more specific articles of the treaty (the Arts 6 through 20) are at issue. K. Vogel, *On Double Taxation Conventions* 386 (The Hague-London-Boston 1997), also concludes that in a case where immovable property attributable to a PE is situated in the residence state, Art. 21 will apply. In the present author's view, however, Art. 7 will in principle apply to such income, unless the proposed contextual interpretation is followed. R.-A. Papotti & N. Saccardo, *Interaction of Articles 6, 7 and 21 of the 2000 OECD Model Convention*, 56(10) Bull. Intl. Taxn. 516, 516 et seq. (2002), argue that Art. 7 is not intended to govern income from immovable property, and they bring forward several arguments supporting this view, resulting in the application of Art. 21(1) as confirmed by Art. 21(2). In the present author's opinion, however, neither Art. 6(4) nor Art. 7(4) prevents State S from applying Art. 7 of the R-S tax treaty to income from immovable property located in State R. Concurringly, D. Sanghavi, *The Interaction of Articles 6, 7 and 21 of the 2014 OECD Model Tax Convention: A Historical Analysis*, 44(8/9) Intertax 651, 656 (2016), concludes on the basis of an analysis of historical documents related to the OECD Model that Art. 6(4) does not intend to remove income from the scope of Art. 7 in favour of Art. 21.

[24] Rust (2002), *supra* n. 7, at 15 et seq., proposes an innovative interpretation of Art. 7(4), since the taxation right of the PE state pursuant to Art. 7(1) is not intended by the OECD Commentary and not in conformity with the situs principle. According to Rust, the expression 'items of income not dealt with separately' in that provision should be interpreted as 'types of income not dealt with separately'. This interpretation would remove the income from the scope of Art. 7, because the type of income is by its nature covered by Art. 6 of the OECD Model, which cannot apply to immovable property located in the residence state or a third state. Consequently, the way to Art. 21 is open. *See also* Rust (2008), *supra* n. 7, at 330. In the same sense, *see*, e.g. Seitz, *supra* n. 7, at 269 et seq. This view removes the inconsistency between Art. 7(1) and Art. 21(2) because it assigns an independent meaning to Art. 21(2), rather than a declaratory meaning. However, as set out in s. 2, the present author does not consider Art. 21(2) to have the independent meaning assigned to this provision by Rust. Moreover, the author does not agree with the interpretation of Art. 7(4) as proposed by Rust.

[25] If State S considers Art. 21(1) to be applicable, there is no double taxation.

[26] OECD Commentary on Arts 23 A and 23 B, para. 32.5. *See also* F.S. Scandone, *The Interaction Between Business Profits and Income from Immovable Property Under Tax Treaties: Is It All About Definitions?*, 37(4) Intertax 223, 225 (2009).

be found in the application of Article 24(3) of the OECD Model.[27] Based on this provision, it can be argued that the PE in State S may not be treated less beneficially than an enterprise of a resident of State S carrying on the same activities. An enterprise of State S with immovable property in State R would have access to the tax treaty between State S and State R. Under Article 6 of the R-S tax treaty, State R would have the right to tax the immovable property, and State S would have to provide relief from double taxation. It can be argued that when the R-S tax treaty prescribes the exemption method in respect of income from immovable property, State S may not tax the income from the immovable property (to tax being understood as to 'effectively tax') by virtue of Article 24(3) in combination with Articles 6 and 23 A(1) of the R-S tax treaty. Accordingly, State R would not be obliged to exempt the profits of the PE under Article 23 A(1) of the R-S tax treaty, to the extent that these consist of income from the immovable property in State R, because State S may not tax this income in accordance with the R-S tax treaty. In effect, State R will then have the exclusive taxation right as regards this income (because it is part of the business profits of the enterprise of State R). However, the author believes that this is a far-reaching interpretation of the phrase 'in accordance with the provisions of this Convention (…) may be taxed' in Article 23 A(1) of the R-S tax treaty. It could equally well be argued that State S may tax the income in accordance with the provisions of the R-S tax treaty if it considers the income to be part of the business profits attributable to the PE in State S, regardless of whether State S has any obligation to prevent double taxation under the 'reverse operation' of the R-S tax treaty following from Article 24(3). The suggested contextual interpretation of Article 7 of the R-S tax treaty provides a stronger basis to argue that State S may not tax income from immovable property situated in State R, because it directly removes the income from the scope of Article 7, without depending on the 'reverse operation' of the treaty.

3.4 *Immovable Property in State T*

3.4.1 *Proposed Approach*

Similar to immovable property situated in State R (see section 3.3), the author suggests an approach to deal with immovable property situated in State T in which Article 21(2) plays a significant role. In the author's opinion, in the example depicted in Figure 2, the 'context' of Article 3(2) of the R-S tax treaty requires that State S cannot apply Article 7, regardless of its domestic law classification of the income as business profits. The context for this purpose consists of Article 21(2) of the R-S tax treaty, which indicates – through the exclusion of immovable property – the implicit objective of the OECD Model that income from immovable property situated in State T should be taxed exclusively in State R under the R-S tax treaty. In addition, the OECD Commentary on Articles 23 A and 23 B cited in section 3.2 above could be considered relevant context. This part of the Commentary also supports the conclusion that State S should not be allowed to tax the income from the immovable property located in State T. The author is of the opinion that this contextual interpretation prevents State S from characterizing income from immovable property located in State T as business profits under Article 7. Consequently, Article 21(1) of the R-S tax treaty has to be applied in respect of the income from the immovable property in State T, so that State S is not allowed to exercise its tax jurisdiction.[28] At the same time, under Article 6 of the R-T tax treaty, State T – the situs state – is entitled to tax the income.

The outcome of the suggested approach is in accordance with the situs principle. Moreover, the proposed approach results in a parallel outcome for both income from immovable property situated in State T and capital gains from the alienation of such immovable property under the R-S tax treaty.[29]

The suggested approach raises some difficulties that are not as pressing in the assessment of immovable property located in State R. First of all, the question is how the term 'immovable property' in Article 21(2) must be interpreted. In this case Article 21(2)'s reference to Article 6(2) is problematic, because the latter provision only refers to immovable property situated in a contracting state, whereas the immovable property is situated in a third state (State T).[30] Accordingly, the term 'immovable property' in Article 21(2) must be interpreted by employing Article 3(2), which means that the meaning of this term must be derived from the law of the state applying the treaty, unless the context otherwise requires. This raises the possibility of conflicting definitions of immovable property when the States R and S apply their own

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[27] *See* Rust (2008), *supra* n. 7, at 329, n. 5.

[28] Notwithstanding this suggested approach, income from immovable property in State T that is not treated as business profits under the domestic law of State S does not fall within the scope of Art. 7 from the start. In that case, Art. 21(1) applies to the income, and the exception for income from immovable property in Art. 21(2) affirms this outcome by removing the income from the referral to Art. 7.

[29] *See also* Rust (2008), *supra* n. 7, at 331. Both Art. 13(1) and Art. 13(2) of the R-S tax treaty are inapplicable in respect of a gain on the alienation of immovable property owned by a resident of a State R that is located in State T and that is attributable to a PE in State S. Consequently, Art. 13(5) of the R-S tax treaty assigns the exclusive right to tax gains from the alienation of the immovable property to State R, preventing State S from taxing these gains under the R-S tax treaty.

[30] As indicated by Rust (2008), *supra* n. 7, at 331, n. 11, the domestic law of State R, State S and State T could be decisive. Rust does not express a preference.

domestic law definitions. However, the author submits that the context within the meaning of Article 3(2) of the R-S tax treaty may also provide a solution for these types of conflicts.

In the author's view, relevant context is provided by the tax treaty between State R and the third state in which the immovable property is situated, i.e. State T. As a result, Article 6(2) of the R-T tax treaty influences the interpretation of the term 'immovable property' for purposes of Article 21(2) of the R-S tax treaty. Moreover, the author takes the position that the relevant context encompasses the tax treaty between State S and State T. Therefore, the interpretation of the term 'immovable property' in Article 21(2) of the R-S tax treaty should also take into consideration Article 6(2) of the S-T tax treaty. This context leads towards an interpretation of the term 'immovable property' in Article 21(2) of the R-S tax treaty by reference to the domestic law of the state in which the property is situated, i.e. State T (provided all these treaties follow the pattern of the OECD Model). This outcome would be in conformity with the situs principle. The suggested approach implies that if State S, when applying its own domestic law definition, does not consider the property in State T to be immovable, it would be required to accept the qualification of the property as immovable under State T's domestic law. As a result, State S would be bound by the characterization of the property as immovable property by State T. Nevertheless, the author believes that the dependency on the domestic law of State T is not without limitations, since the application and interpretation of the R-S tax treaty is generally governed by the principle of good faith (Articles 26 and 31(1) of the VCLT). Consequently, the good faith principle may restrict the use of State T's domestic law definition of immovable property, e.g. if State T were to unilaterally expand its taxation rights under Article 6 of either the R-T tax treaty or the S-T tax treaty. State T may attempt to do so by broadening the scope of its domestic law concept of immovable property, and thus the scope of Article 6(2) of the R-T tax treaty and the S-T tax treaty, to the effect that items of income are shifted from another distributive rule to Article 6 of these tax treaties, the latter provision giving State T a more comprehensive right to tax. In such a case, State S would not be required to adhere to State T's domestic law definition of immovable property.

In the case where the R-S tax treaty does not contain a provision similar to Article 21(2), the proposed approach cannot be applied because there is no context preventing State S from characterising income from immovable property located in State T as business profits under Article 7. As a result, State S may in that case tax the profits that are attributable to that PE, including income from immovable property in State T, pursuant to Article 7(1).

The author recognizes that, to the extent that the R-T tax treaty and the S-T tax treaty are considered elements of the context for purposes of the R-S tax treaty, the definition of the term 'immovable property' in Article 21(2) of the R-S tax treaty is made dependent on the law of a state that is not a party to the latter tax treaty. In more general terms, the operation of one treaty has an effect on the operation of another tax treaty. In the author's view, this approach is not unprecedented.[31] See, for example, paragraph 8.2 of the OECD Commentary on Article 4, and the judgements of the Dutch *Hoge Raad* of 28 February 2001, *BNB* 2001/295, 8 February 2002, *BNB* 2002/184, and 11 May 2007, *BNB* 2007/230, which demonstrate that the interaction between tax treaties may entail that one treaty has an influence on the application of another treaty.[32]

One of the obvious objections against the proposed contextual approach is that the definition of immovable property in Article 21(2) of the R-S treaty is rendered dependent on the domestic law of a state that is not a party to the treaty. Moreover, the context provided by the OECD Commentary on Articles 23 A and 23 B may be less persuasive than in the case of immovable property situated in State R (see section 3.3). Notably, paragraph 4 of the OECD Commentary on Article 21 only refers to immovable property situated in the residence state, but

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[31] *See also* Fett, *supra* n. 9, at 88 et seq.

[32] According to para. 8.2 of the OECD Commentary on Art. 4, a company cannot be considered a resident of a contracting state within the meaning of Art. 4 of the OECD Model in the event that the company, while being a resident of that state under its domestic tax law, is considered to be a resident of another state pursuant to a tax treaty between these two states. Furthermore, the judgement of the Dutch *Hoge Raad* of 28 Feb. 2001, *BNB* 2001/295, demonstrates that a company which is no longer subject to unlimited taxation in the Netherlands as a result of the operation of a tax treaty is also no longer a resident of the Netherlands for purposes of other tax treaties concluded by the Netherlands with third states. In the author's view, these various examples show that one tax treaty can have an impact on the application of another tax treaty. Another area where this idea finds application concerns triangular cases involving PEs. An example of such a case involves dividends paid to an enterprise residing in a contracting state (State R) by a company residing in a third state (State T), whilst the shares in respect of which the dividends are paid are effectively connected with a PE located in State S. It is assumed that the credit method is applicable under the R-T tax treaty and the exemption method applies under the R-S tax treaty. In this example, State R is required to apply the relief provisions of both the R-S and the R-T tax treaties, which in principle results in a dual obligation to provide relief from double taxation. However, the author takes the position that State R is not required to provide a credit for the taxation on the dividend by State T under the R-T tax treaty to the extent that the dividend from State T is attributable to the profits of the PE that are, consequently, exempt under the R-S tax treaty. In the author's view, the tax attributable to the dividend for purposes of calculating the credit under Art. 23 A(2) or 23 B(1) of the R-T tax treaty is reduced as a result of the exemption of the PE profits to be applied by State R under Art. 23 A(1) of the R-S tax treaty. This outcome corresponds to the decisions of the Dutch *Hoge Raad* of 8 Feb. 2002, *BNB* 2002/184, and 11 May 2007, *BNB* 2007/230, although these decisions were based on a different reasoning. According to the *Hoge Raad*, the object and purpose of the credit provision of the R-T tax treaty prevailed over the literal wording of this provision. Furthermore, the interaction of tax treaties plays a role in determining the position of State S. The author adheres to the view that State S must provide relief on the basis of the non-discrimination clause of Art. 24(3) of the R-S tax treaty in combination with Arts 10 and 23 A or B of the S-T tax treaty. Compare the OECD Commentary on Art. 24, paras 69 et seq. State S must fulfil this obligation irrespective of the fact that the S-T tax treaty is not applicable since the recipient of the dividend is not a resident of either contracting state.

not to immovable property located in a third state. As a result, the exclusion of immovable property in Article 21 (2) may not have the desired effect of preventing State S from taxing income from the immovable property in State T under Article 7 of the R-S tax treaty. In the author's view, an amendment of the OECD Commentary could reinforce the approach defended here. The author recommends adding language to the OECD Commentary on Article 21 which confirms the inapplicability of Article 7 to income from immovable property situated in a third state.[33]

3.4.2 *Alternative Solutions*

Various authors have argued that Article 21(1) of the R-S tax treaty should also apply to income from immovable property situated in State T and which is attributable to a PE in State S.[34] In comparison to the case of immovable property situated in State R, however, there seems to be less agreement that the application of Article 7 of the R-S tax treaty can – or should – be avoided in these circumstances.[35]

In this triangular case, two treaties are involved.[36] Under Article 6 of the R-T tax treaty, State T may tax the income. Under the R-T tax treaty, State R is obliged to grant an exemption (under Article 23 A) or a credit (under Article 23 B).[37] Under Article 7 of the R-S tax treaty, State S taxes the profits attributable to the PE, assuming State S does not follow the approach proposed in section 3.4.1. Under the R-S tax treaty, State R could then take the view that Article 21 (1) of the R-S tax treaty applies, resulting in unresolved double taxation.[38] Although the S-T tax treaty is not applicable, various authors have proposed that Article 24(3) of the R-S tax treaty could require State S to provide relief from double taxation in respect of the income from immovable property located in State T under the S-T tax treaty.[39] By virtue of Article 24(3) of the R-S tax treaty in combination with Articles 6 and 23 A(1) of the S-T tax treaty, State S may tax the income from the immovable property attributable to the PE there, but State S would be obliged to provide relief from double taxation in respect of the tax levied in State T. It may be argued that when the S-T tax treaty prescribes the exemption method in respect of income from immovable property, State S may not tax the income from the immovable property (to tax being understood as to 'effectively tax') by virtue of Article 24 (3) of the R-S tax treaty in combination with Articles 6 and 23 A(1) of the S-T tax treaty. Accordingly, State R would not be obliged to exempt the profits of the PE under Article 23 A(1) of the R-S tax treaty, to the extent that these consist of income from the immovable property in State T, because State S may not tax this income in accordance with the R-S tax treaty, as follows from Article 24(3) of that treaty. In the author's view, however, this interpretation of the phrase 'in accordance with the provisions of this Convention (…) may be taxed' in Article 23 A(1) of the R-S tax treaty is too extensive. It can equally well be argued that State S may tax the income in accordance with the provisions of the R-S tax treaty if it considers the income to be part of the business profits attributable to the PE in State S, regardless of whether State S has any obligation to prevent double taxation in accordance with the S-T tax treaty that may result from Article 24(3) of the R-S tax treaty. The author's suggested contextual interpretation of Article 7 of the R-S tax treaty provides a

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[33] *See* Bosman, *supra* n. 2, at 535 et seq. for a textual proposal.

[34] Ward et al., *supra* n. 10, at 374, n. 94, take the position that income from immovable property situated in a third state is 'other income', even if the immovable property is effectively connected with a PE in the other state, although potentially this income is covered by Art. 7. According to Rust (2002), *supra* n. 7, at 17, the case of immovable property in a third state has to be solved on the basis of Art. 7(4), in an analogous way to the case of immovable property situated in the residence state, resulting in the application of Art. 21(1). *See also* Rust (2008), *supra* n. 7, at 331. Concurring, Seitz, *supra* n. 7, at 269 et seq. Compare the view taken by Rust (2015), *supra* n. 7, at 1557, that Art. 21(1) applies primarily on the basis of independent function of Art. 21(2). According to Papotti & Saccardo, *supra* n. 23, at 516 et seq., Art. 21(1) applies to income from immovable property in a third state, because income from immovable property can never fall under Art. 7. Scandone, *supra* n. 26, at 223 et seq. also argues in favour of the application of Art. 21(1), taking the view that income from immovable property can never be business income as defined with the aid of Art. 3(2). According to Saccardo, *supra* n. 22, the exception for immovable property in Art. 21(2) is a stand-alone distributive rule, rather than a clarifying provision. In case of income from immovable property situated in State T which is considered as business profits by State S, Art. 7(4) resolves the conflict between Art. 7 and Art. 21(2) in favour of the latter provision.

[35] For instance, Vogel, *supra* n. 23, at 386, took the view that Art. 7 will continue to apply to the taxation of income from immovable property in a third state. According to Arnold, *supra* n. 22, at 12, n. 44, the exception in Art. 21(2) does not apply to income from immovable property located in a third state, because the income is not covered by Art. 6(2)'s bilateral scope. Consequently, the PE state is entitled to tax the income. Fett, *supra* n. 9, at 46 and 50, takes a similar approach, arguing that the exclusion of immovable property in Art. 21(2) is only intended to apply to property situated in the residence state. According to Fett, *supra* n. 9, at 47–48, the exclusion of immovable property in Art. 21(2) of the R-S tax treaty does not have any effect in a case where the income is not considered to be part of business profits according to State S for purposes of the R-S tax treaty. This is because the definition of Art. 6(2) does not apply to immovable property situated in a third state. Consequently, the main rule of Art. 21(2) has the effect of assigning the taxation right to State S under Art. 7 of the R-S tax treaty.

[36] *See* for a discussion of this case and various possible solutions, e.g. E. Reimer, *Income from Immovable Property (Article 6 OECD Model Convention)*', in *Source Versus Residence* 4–7 (Lang, Pistone, Schuch, Staringer eds, Alphen aan den Rijn: Kluwer Law International 2008). *See also* Fett, *supra* n. 9, at 40 et seq.

[37] Based on the decisions of the Dutch *Hoge Raad* of 8 Feb. 2002, *BNB* 2002/184, and 11 May 2007, *BNB* 2007/230, if the credit method is applicable under the R-T tax treaty, and the exemption method under the R-S tax treaty, then State R is not obliged to credit the tax levied by State T under the R-T tax treaty, to the extent that the income from State T is attributable to the profits of the PE and therefore exempt under the R-S tax treaty. In these circumstances, the income is considered to be excluded from the Dutch tax basis for purposes of the R-T tax treaty.

[38] OECD Commentary on Arts 23 A and 23 B, para. 32.5. *See also* Scandone, *supra* n. 26, at 225.

[39] *See* e.g. Reimer, *supra* n. 36, at 6–7; Fett, *supra* n. 9, at 49–50 and 107 et seq.

stronger basis to argue that State S may not tax income from immovable property situated in State R under the R-S tax treaty, because it directly removes the income from the scope of Article 7 of the R-S tax treaty without depending on Article 24(3) of the R-S tax treaty in combination with Articles 6 and 23 A(1) of the S-T tax treaty.

A detailed discussion of solutions to resolve PE triangular cases is outside the scope of this article.[40] With regard to the role of Article 21 within the current framework of the OECD Model, the author takes the view that the 'other income' article can be instrumental in resolving PE triangular cases involving immovable property, to the extent that State S is prevented from taxing income from immovable property situated in State T under the proposed contextual interpretation of Article 7 of the R-S tax treaty.

4 Proposed amendment of article 21

The approach suggested in sections 3.3.1 and 3.4.1 implies that the term 'profits of an enterprise' at the tax treaty level comprises everything that is regarded as such under the domestic tax law of the state applying the treaty, with the exception of income from immovable property situated in the residence state or in third states (which is 'other income').[41] Even if the OECD Commentary is amended, the scope of the exception for immovable property in Article 21(2) may remain unclear in relation to immovable property situated in a third state. To improve the effectiveness of the exclusion of immovable property from the scope of Article 21(2), the author proposes amending Article 21 to ensure that the PE state is not entitled to tax income from immovable property situated in the residence state or in a third state. This could be achieved by replacing the current paragraph 2 of Article 21 with the following two paragraphs:

> *2. The provisions of paragraph 1 shall not apply to income, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein and the right or property in respect of which the income is paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.*
>
> *3. Notwithstanding the provisions of paragraph 2 of this Article and Article 7, the provisions of paragraph 1 shall apply if a resident of a Contracting State, carrying on business in the other Contracting State through a permanent establishment situated therein, derives income from immovable property situated in a State different from the other Contracting State, and the immovable property is effectively connected with such permanent establishment. For purposes of this provision, the term 'immovable property' shall have the meaning which it has under the law of the State in which the property in question is situated. The provisions of Article 6, paragraphs 2 and 3 shall apply accordingly.*

The proposed third paragraph applies as an exception to both Article 21(2) and Article 7 of the tax treaty between the residence state and the PE state (State R and State S, respectively) where the contracting states would consider either provision to be applicable to income from immovable property situated in the residence state or in third states. As a result of this rule, the residence state has the exclusive right to tax the income from the immovable property under the tax treaty with the PE state. The tax treaty between State R and State T (the situs state) will determine whether or not the residence state must provide relief from double taxation in respect of taxation of the income from the immovable property in the situs state. In effect, immovable property situated in the residence state or in a third state that is effectively connected with a PE in the other contracting state is treated in the same way as such immovable property that is not effectively connected with a PE (see section 3.1).

In compliance with the situs principle, the term 'immovable property' is defined by reference to the laws of the state where the property is situated, regardless of whether or not the situs state is a contracting state. This avoids complications regarding the definition of this term when the property is situated in a third state. To ensure that the provisions of Article 6 are fully applicable, the remainder of Article 6(2) and Article 6(3) is declared applicable by analogy. Admittedly, the definition of the term 'immovable property' is made dependent on the law of a state that is not a party to the tax treaty. However, in the author's view, this approach would be in accordance with the situs principle.

5 Summary and conclusions

The scope of the exception for immovable property in Article 21(2) of the OECD Model is unclear. In the case of immovable property that is situated in the residence state (State R) or in a third state (State T) and that is

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[40] Fett, *supra* n. 9, at 225 et seq. and 553 et seq., proposes various solutions to resolve triangular cases like the one described here.

[41] In the case of dividends, interest and royalties that are attributable to a PE in State S and falling outside the geographical scope of the Arts 10, 11 and 12 of the R-S tax treaty, the author believes that the characterization of this income as business profits within the meaning of Art. 7 of the R-S tax treaty is not prevented by any context. The context referred to in the case of immovable property situated in State R or in State T, consisting of the exception for immovable property in Art. 21(2) as well as certain parts of the OECD Commentary, indicates a deviation from the interpretation of Art. 7 in accordance with the domestic law of State S. However, if Art. 21(2) is considered relevant context for the present purposes, then Art. 21(2) actually confirms the interpretation of Art. 7 in accordance with the domestic law of State S because the tax jurisdiction under Art. 21(2) is as a rule assigned to the PE state.

attributable to a PE in the other contracting state (State S), the author takes the view that the 'context' within the meaning of Article 3(2) of the R-S tax treaty – including Article 21(2) of the R-S tax treaty – prevents State S from categorising the income under Article 7 of the R-S tax treaty, regardless of its domestic law classification of the income as business profits. Consequently, Article 21(1) of the R-S tax treaty has to be applied in respect of the income from the immovable property located in State R or in State T. To reinforce this proposed approach, the author recommends adding language to the OECD Commentary on Article 21 which confirms the inapplicability of Article 7 to income from immovable property situated in State R or in State T which is derived by an enterprise. Regardless of the proposed changes to the OECD Commentary, the effectiveness of the exclusion of immovable property from the scope of Article 21(2) could be further improved. Therefore, it is proposed to amend Article 21 to ensure that the PE state is not entitled to tax income from immovable property situated in State R or in State T.