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Liable to tax by reason of residence… or any other criterion of a similar nature

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When is a taxpayer a resident of a contracting state for purposes of a tax treaty? The decades old definition in article 4(1) of the OECD Model that '"resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature' remains a subject of contention *Canada v Alta Energy Luxembourg S.A.R.L.*, 2020 FCA 43 (CanLII) (See for example http://kluwertaxblog.com/2020/02/27/alta-energy-treaty-shopping-is-no-abuse/)

This central question was one of the issues before the UK First-tier Tribunal in *G E Financial Investments Ltd v HMRC* [2021] UKFTT 210 (TC) last month. The case involves a complex intra-group financing arrangement by the US-headed multinational group, the General Electric Company (GEC). The case raises other key tax treaty issues – the existence of a permanent establishment under article 7 and credit for foreign tax under article 24 of the UK-US Income Tax Treaty. Given the complex and wide-ranging decision, these other issues will be the subject of separate blogs.

Stapled stock

The taxpayer, G E Financial Investments Ltd (GEFI) was incorporated in the UK. Its share could only be transferred at the same time as those of GE Financial Investments Inc. ("GEFI Inc.") a US incorporated member of the GEC group. As such they were treated as "stapled stock" for US tax purposes. One consequence was that GEFI, the UK incorporated company was treated as a domestic corporation for US tax purposes of and therefore liable to US federal income tax on its worldwide income.

Although treated as a US person the UK company was still treated as a foreign corporation for purposes of the US branch profits tax and is unable to join in the filing of a consolidated group tax return. Furthermore, it was precluded from exemption from US income tax by reason of any treaty. These differences raise questions of discrimination under article 26 of the Treaty but were not raised in this case.

UK- US Income Tax Treaty

Article 4 of the UK- US Income Tax Treaty is similar, but not identical to the OECD Model. It reads in relevant part:

4(1… the term "resident of a Contracting State" means, for the purposes of this Convention, any

person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or of profits attributable to a permanent establishment in that State.

4(5) Where by reason of the provisions of paragraph 1 of this Article a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the mode of application of this Convention to that person. If the competent authorities do not reach such an agreement, that person shall not be entitled to claim any benefit provided by this Convention, except those provided by paragraph 4 of Article 24 (Relief from Double Taxation), Article 25 (Non-discrimination) and Article 26 (Mutual Agreement Procedure)

The UK and US competent authorities held discussions under article 4(5) but were unable to agree the mode of application of the Treaty to the UK company, GEFI.

Where is the beef?

Although it is not clear from the decision, what would be achieved by a conclusion that GEFI was a US resident in addition to being a UK resident under article 4(1) of the Treaty, the taxpayer argued that it was also US resident under article 4(1). It is also unclear why HMRC contested the issue – the discussions between the competent authorities pursuant to article 4(5) are predicated on the taxpayer being a resident of both states!

“any other criterion of a similar nature”

The dispute centred around the meaning of the expression “any other criterion of a similar nature” in Article 4(1). The taxpayer argued that it referred to any criterion enacted under the domestic law of a contracting state for the imposition of full or worldwide taxation. The stock staple did this. This interpretation was fully supported by paragraphs 4 and 8 of the OECD Commentary on article 4. It was also consistent with the decision of the Supreme Court of Canada in *Crown Forest Industries v Canada* [1995] 2 SCR 802 (the leading judicial authority on the subject).

The First-tier Tribunal accepted the HMRC argument that for there to be “criterion of similar nature” there must, in addition to the imposition of a worldwide liability to tax, also be an attachment or connection to a contracting state similar to domicile, residence, citizenship, place of management, place of incorporation etc. In doing so, the Tribunal relied on Klaus Vogel on Double Taxation Conventions and, a chapter in Guglielmo Maisto’s Residence of Companies under Tax Treaties and EC Law, “The Expression ‘by reason of His Domicile, Residence, Place of Management ….’ As Applied to Companies” by Marcel Widrig. It considered *Crown Forest* as authority for the proposition that full or worldwide taxation is a necessary feature of the connecting criterion but not sufficient of itself. The Tribunal decided that the share stapling was not such a connecting criterion as it has no US law consequences at federal or state level.

Principles of treaty interpretation

In my view, the taxpayer’s arguments are correct. The whole expression “liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature” is to be construed and not dissected to seek a literal meaning of

the elements. Non-tax effects of the domestic law should be irrelevant. It is curious that although the Tribunal cited the UK Supreme Court in *Fowler v HMRC* [2020] 22 for the principles of treaty interpretation, it took this approach, in particular making no reference to the purpose of the Treaty or article 4(1) when purpose formed the basis of the Supreme Court conclusions in *Fowler*.

The Permanent establishment and foreign tax credit issues will be discussed in later blogs.

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This entry was posted on Thursday, July 22nd, 2021 at 4:41 pm and is filed under Canada, Corporate income tax, Double Taxation, International Tax Law, MAPs and APAs, MNEs, OECD, Permanent Establishments, Residence, Tax Treaties, United Kingdom, United States
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