THE TIEBREAKER RULE FOR TAX RESIDENCE OF COMPANIES UNDER THE MLI

A critique of the tiebreaker rule for tax residence of companies under the MLI

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Título

Regla de desempate para la residencia fiscal de empresas en el marco de la LMI

Crítica a la regla de desempate para la residencia fiscal de las empresas en virtud de la LMI

Resumen

El informe que los "cuatro economistas" presentaron a la Liga de Naciones a principios de la década de 1920 se considera el trabajo más influyente hasta la fecha en el ámbito de los convenios fiscales. Su trabajo dio forma al diseño de los convenios fiscales y defendió de forma extraordinaria y pionera la eliminación de los impedimentos de doble imposición a la libre circulación de capitales en una economía posterior a la primera guerra mundial que intentaba desesperadamente globalizarse. Los cuatro economistas también argumentaron en su informe que la teoría de la lealtad económica era la clave para determinar la residencia fiscal de las empresas en casos de doble residencia fiscal. Si bien reconocían la dificultad de repartir el capital entre múltiples jurisdicciones cuando la actividad de una empresa traspasa fronteras, y evitaban que criterios de lealtad política como el lugar de constitución determinaran la residencia fiscal de las empresas, sostenían que el lugar donde la empresa tiene su sede o donde se reúnen los "cerebros" de la empresa debería ser el factor que determinara la jurisdicción a la que la empresa debe su lealtad económica y donde, por tanto, debería tributar. En consecuencia, durante los siguientes noventa y cinco años, en un movimiento defendido en gran parte por la Organización para la Cooperación y el Desarrollo Económico (OCDE), su idea pasó a

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conocerse como el criterio del "lugar de dirección efectiva" (LDE) para romper la doble residencia fiscal, y un enorme porcentaje de convenios fiscales han adoptado diversas formas del LDE. Sin embargo, en un cambio radical de enfoque en 2017 a través de enmiendas al proyecto de Modelo de Convenio Tributario de la OCDE y el diseño del Convenio Multilateral para la Aplicación de Medidas Relacionadas con los Tratados Fiscales para Prevenir la Erosión de la Base Imponible y el Traslado de Beneficios (el MLI); la OCDE ahora aboga por el procedimiento de acuerdo mutuo y la denegación de los beneficios del tratado como el enfoque preferido para resolver los casos de doble residencia fiscal de las empresas. Si bien las deficiencias de los criterios del POEM exigían una revisión urgente, el cambio radical de planteamiento cuestiona si el nuevo se ajusta a la teoría de la vinculación económica, o si pondrían fin a los problemas asociados a los criterios POEM o si la teoría de la vinculación económica es un concepto obsoleto que no sirve para resolver la doble residencia fiscal en los tratados fiscales futuros. Este trabajo, por tanto, pretende intentar dar respuesta a estas preguntas, analizar la eficacia de las reglas de desempate en el MLI y hacer recomendaciones de mejora.

Palabras clave

Residencia fiscal de las empresas, procedimiento amistoso, lugar de dirección efectiva, convenio, OCDE, BEPS.

Abstract

The report of the "four economists» in the early 1920s to the league of nations is widely regarded in tax treaty literature as the most influential body of work yet. Their work shaped the design of tax treaties and argued in an extraordinary and groundbreaking manner for the removal of double tax impediments to the free flow of capital in a post-world war one economy desperately trying to become globalized. The four economists also argued in their report that the economic allegiance theory was the key to determining the tax residence of companies in instances of dual tax residence. While recognizing the difficulty in apportioning capital across multiple jurisdictions where a company’s business crosses borders, and eschewing political allegiance criteria such as place of incorporation from determining corporate tax residence; they argued that where the company is headquartered or where the "brains» of the company meet should be the factor that determines the jurisdiction the company owes its economic allegiance, and where it should therefore be taxed. Consequently, for the next ninety-five years, in a movement championed in large part by the Organisation for Economic Cooperation and Development (OECD), their idea came to be known as the "place of effective management» (POEM) criteria for breaking dual tax residence, and a huge percentage of tax treaties have adopted varying forms of the POEM. However, in a radical shift in approach in 2017 through amendments to the draft OECD Model Tax Convention and the design of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the MLI); the OECD now advocates for mutual agreement procedure and denial of treaty benefits as the preferred approach to resolving cases of dual tax residence of companies. While the shortcomings of the POEM criteria called for an urgent review, the radical change in approach questions whether the new approach aligns with the economic allegiance theory or whether this approach would bring an end to problems associated with the POEM criteria or whether the economic allegiance theory is an outdated concept that serves no useful role in resolving dual tax residence in the tax treaties of the future. This paper, therefore, seeks to attempt to provide an answer to these questions, analyse the efficacy of tiebreaker rules in the MLI, and make recommendations for improvement.

Keywords

Tiebreaker, corporate tax residence, mutual agreement procedure, place of effective management, tax treaty, treaty benefits, OECD, BEPS.

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1. Introduction

The foundation of international tax law is built on the application of over 3,000 bilateral tax treaties[1] and the main objective of these tax treaties is to prevent double taxation of individuals and companies operating across borders. By so doing, the international tax system aids the free flow of capital, facilitates international business transactions, and enables an interchange of professionals between countries.[2] Modern business and the current scale of globalization could not have been functional without the application of tax treaties.

However, tax treaties cannot function by themselves. Like many other aspects of international law, it needs a connecting factor. For a tax treaty to apply to any given company or individual, such individual or company must be deemed to be resident of one of the contracting states to the treaty. Residence is therefore the connecting factor for the application of tax treaties in the international tax system.[3] In this sense, residence is often conceived as binary; a company or individual is either deemed to be resident of a country or not. However, despite this binary conception of residence, instances of dual residence tend to arise. Dual residence is possible when applying treaties because where an entity is deemed to be resident is usually a legal question that treaties leave to be answered by domestic law. Thus, there are instances where an entity qualifies for residence in both contracting states. Sometimes, this is because of both contracting states applying different rules of residence that make an entity resident in both contracting states. In the case of companies, one country may be incorporated in one state and have its managers resident in another state. Where both states in this example are parties to a tax treaty and they determine residence of companies based on place of incorporation and POEM respectively, then we have a case of dual residence for such a company.

Resolving dual tax residence is therefore key to the application of a tax treaty to a company. This is because where a company is resident is ultimately a defining factor in the allocation of taxing powers under any tax treaty. Otherwise, both countries tax the company and this defeats the purpose of the tax treaty which is to prevent the double taxation of profits of companies or individuals operating in its jurisdiction. As the succeeding sections will show, determining where a company is resident in cases of dual tax residence is not an easy task. Decades of legal, economic and policy thought have been devoted to providing an answer to this problem and they have not been very successful. Thus, there has been no satisfactory rule for determining where a company is resident, especially in cases of dual tax residence.[4] The two predominant tests that have

1 Yariv Brauner, *What the BEPS?* 16 Florida Tax Review, 55, 61 (2014). *See* also Reuven S. Avi-Yonah, *Commentary,* 53 Tax Law Review, 167, 169 (1999).

2 Bernard H. Oetjen, *The Competent Authority's Role in Resolving International Tax Issues,* 26 Tax Executive 57 (1973).

3 *See*, David Elkins, *A Scalar Conception of tax Residence*, 41 Virginia Tax Review, 149, 157 (2022).

4 Yariv Brauner, *International Trade and Tax Agreements May be Coordinated But Not Reconciled,* 25 Virginia Tax Review, 252, 279 (2005).

been developed to resolve this dilemma have been the POEM test and the place of incorporation test. They have been the subject of criticisms which all boil down to a conclusion that they are not effective for truly determining the tax residence of companies and can easily be manipulated to gain tax advantage.[5] With the emergence of a new international tax order[6] motivated by the efforts of the OECD to combat harmful tax practices of multinational enterprises (MNEs), this question of resolving dual tax residence has resurfaced. Now, the OECD —through the MLI[7]—proposes a new rule that is interesting for two main reasons. First, this rule is a deviation from the global standard that the OECD has worked hard to establish for decades, and insisted on in its model despite criticisms in tax treaty literature and criticisms from opposing institutions involved in designing model tax conventions, like the United Nations. Second, this rule seems to adopt a rather discretionary approach to resolving dual tax residence for companies which also denies treaty benefits, i.e., relief from double taxation altogether, where the dual tax residence situation is not resolved.

Clearly, the possible application of this rule raises a number of issues for the international tax order if the rule is adopted in treaty practice.[8] First, is the OECD's adoption of this rule in line with the close to a century of legal and economic theory that serves as a foundation for the resolution of dual tax residence? And if it does not align with this, is there another alternative to be explored that aligns with the theoretical foundations for resolving dual tax residence? Second, is the new rule going to be effective? This is important because for decades, the generally accepted position in tax treaty literature has been that there is no perfect tiebreaker rule for determining dual tax residence of companies as the POEM rule was considered to be unworkable.[9] If the OECD has invested this much effort into the design of a new rule, then it is in order to hope that the rule is at least a more effective approach.

This paper shall seek to answer these questions and comprehensively trace the evolution of tiebreaker rules in tax treaties. The paper shall also seek to ascertain whether we have finally arrived at a solution for resolving the case of dual tax residence of companies or whether the approach takes us further away from a solution.

Thus, the second part of this paper shall follow the historical evolution of tiebreaker rules for companies in tax treaty law. This part shall trace the evolution from the work of the four economists to the work that is being caried out by

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5 *See,* Cian Carroll, *Corporate Residence, Taxation and E-Commerce-Domestic and Treaty Law Tests of Company Residence for Tax Purposes in the Context of Modern Communications,* 10 Irish Student Law Review 32 (2002).

6 Joao Marcus de Melo Rigoni, *The International Tax Regime in the Twenty-First Century: The Emergence of a Third Stage,* 45 Intertax 205 (2017). For a general and more expansive definition and explanation of the evolution of the international tax order, *see,* Eduardo Baistrocchi, *The International Tax Regime and Global Power Shifts,* 40 Virginia Tax Review, 219 (2021).

7 For an extensive discussion of the scope of the MLI and the motivations behind it, *see,* Alexander Bosnan, *General Aspects of the Multilateral Instrument,* 45 Intertax, 642 (2017).

8 While signatures are ongoing and it is still early days (as countries can always decide on adopting the rule in the future), evidence discussed elsewhere in this paper shows that the MLI position has been received negatively by countries signed to the MLI.

9 Yariv Brauner, *Treaties in the Aftermath of BEPS,* 41 Brooklyn Journal of International Law, 973, 999 (2016).

the OECD today towards resolving dual tax residence of companies. The third part of this paper shall analyse the MLI's position on resolving cases of dual tax residence. This part shall also examine the limitations to the rule proposed by the MLI as well as its reception so far by the parties to the MLI. The fourth part of this paper shall make recommendations, in light of the limitations identified in the previous part, for improving the MLI's position. Additionally, the fourth part shall seek to answer the question of whether there is an alternative to resolving dual tax residence which was ignored in the approach taken in the MLI. The fifth and final part of this paper shall conclude the paper.

Thus, to situate the analysis of dual tax residence and the rule proposed to resolving this issue in context, we shall now turn to an analysis of the historical evolution of the rules for resolving dual tax residence in treaties and how these rules have changed over the last half-century.

2. Historical evolution of the tiebreaker rules for corporate tax residence

Unlike in the case of companies, factual and hierarchical tiebreaker rules for tax residence of individuals have existed in tax treaties for a long time. For companies, the prevailing idea in the work and jurisprudence of tax treaty law seemed to be that instances of dual residence with companies were uncommon.[10] It is for this reason that it was thought that there was little justification for a tiebreaker rule for companies. This was complicated by the fact that from the outset, tax treaties never really designed a formal rule for corporate tax residence. For example, the report of the four economists[11] –which was one of the earliest attempts in tax treaty literature to resolve the issue of residence of companies– focused on a substantive analysis of when a company would be deemed to be a tax resident of a particular contracting state.[12] Although their report espoused terms such as "economic allegiance," "domicile", etc. for resolving corporate tax residence, they ultimately decided on ascertaining where the head office is situated or where the most effective work of the corporation can be done as the deciding

10 OECD, *Commentary on Article 4: Concerning the Definition of Resident*, C (4)-10, (Dec. 12, 2022, 11:05AM), https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_830021b7-en#page10 in COMMENTARIES ON THE ARTICLES OF THE MODEL CONVENTION. Accordingly, this early idea about how unproblematic resolving the fiscal residence of companies would be affected its treatment in tax treaties. While hierarchical factors were established for resolving dual residence for individuals, various conceptions and phrasing of the "center of management or place of effective management" have been used for companies over time without sufficient clarity as to what this term actually means.

11 The four economists were Professors Bruins, Enaudi and Seligman and Sir Josiah Stamp. They submitted their report on the impact of double taxation on flow of capital to the financial committee of the league of nations. Their work is very influential in tax treaty literature and often considered to have laid the foundation for the work of the league of nations in designing the double tax treaties that emerged.

12 Sarig Shalhav, *Evolution of Article 4(3) and Its impact on the Place of Effective Management Tie Breaker Rule*, 32 Intertax 460, 464 (2004).

factor for where a company is resident for tax treaty purposes.[13] The report was also groundbreaking in that as far back as the early 1920s, they already recognized the possibility of this management happening remotely.[14] They believed there was a strong nexus between where the company is being effectively managed with where the business was being conducted, to justify the adoption of this test as the basis for deciding residence of companies and ultimately taxing companies.

The work of the four economists formed the basis of the report that was subsequently submitted by technical experts to the league of nations in 1925. In a general comment to the resolution submitted by the technical experts, they recognized how —particularly with respect to maritime and shipping companies— it was possible for a company to continue to operate across various states.[15] While acknowledging difficulties in apportioning profits across the various states, they acknowledged that determining the location of the "brain" of the company would be an effective way to decide its fiscal domicile.[16] They noted that in relation to companies, the fiscal domicile refers to where the company has its "effective center, i.e. the place where the "brain", management and control of the business are situated."[17] Later on in 1927 when four draft conventions were drawn up in London, the term "fiscal domicile" was used to allocate taxing powers to contracting states with respect to companies. Unfortunately, these drafts and the commentary adopted by the committee did not define the term "fiscal domicile". There are some scholars who believe that notwithstanding the lack of a definition, "fiscal domicile" as used by the committee could be interpreted by the report, resolutions and general comments submitted by the technical experts.[18] This seems to be the only logical explanation. Unsurprisingly, several draft conventions by the league of nations over the next decade all seemed to have adopted the center or place of effective management language.[19]

The 1933 draft convention however made a slight departure from the model conventions drafted by the league of nations that came before it. Although the draft still uses the term "fiscal domicile", the protocol to the draft clarifies its meaning as the location where the company has its centre of management. While this draft does better to clarify the concept in the protocol, the interpretation is essentially the same seeing as earlier drafts could be interpreted to

13 Report on Double Taxation, League of Nations Doc. EFS 73 F19 1923, submitted to the Financial Committee by Professors Bruins, Enaudi, Seligman and Sir Josiah Stamp, at 31.
14 *Ibid*, at 30.
15 *See,* League of Nations Doc. F212, *Report and Resolutions submitted by the Technical Experts to the Financial Committee of the League of Nations* (Geneva, 1925). 16.
16 *Ibid.*
17 *Ibid*, at 21.
18 *See, Shalhav supra* note 13 at 466.
19 For instance, the draft convention in 1928 by the league of nations still adopted the same criteria of "fiscal domicile." The drafting and language adopted in the model are essentially in tandem with the spirit of the report of the technical experts submitted in 1925.

define the concept similarly; using the resolutions, general comments, and other *travaux preparatoire* documents.[20]

Following that draft, we had the Mexico and London Model Tax Conventions of 1943 and 1946 respectively.[21] These drafts differed substantially in their approach to breaking the ties of dual corporate tax residence. While the London draft supported the idea of making companies resident where they have their center of management, the Mexico draft was in support of the idea of making companies resident where they are organized, i.e., where the companies were incorporated. This difference between both models is reflective of the difference in legal systems, and differences in approaches to preventing double taxation between the developed and developing world. It was perhaps the perfect foreshadowing of the lack of agreement and unification that would characterize global tax treaty policymaking between developed and developing economies that still haunts the OECD to date.[22]

The predecessor to the OECD, the Organisation of European Economic Cooperation (the OEEC), took the next big steps in global tax treaty development in the late 50s and early 60s. through different reports issued between 1958 and 1961, the OEEC reiterated that in cases of dual residence of companies, the company will be deemed to be resident where it has its place of effective management (POEM). This language was eventually adopted in the 1963 draft and remained unchanged (in substance) in all drafts of the OEEC, and the OECD, between the 1963 draft and 2001.[23] The work of the United Nations (UN) Model was based on the Mexico draft and the UN Model prioritized the place of incorporation rule which had been adopted by the Mexico Model.

Technological advancements and increasing use of remote management were some of the factors that led the OECD to question the POEM as an effective test for determining corporate tax residence in the 2001 and 2003 Business Profits Technical Advisory Group (BP TAG) reports. These reports questioned the viability of alternatives, eschewed the utility of the adoption of place of incorporation and ultimately considered the use of other rules to supplement the POEM test in the OECD Model Tax Convention (the Model). The obvious attempt to clarify the application of the POEM by proposing the adoption of a hierarchical test in the 2003 report was rejected. In a 2008 amendment to the commentary to the Model, the OECD removed the sentence which sought to clarify the POEM as the place where the most senior management personnel meet to make

20 Legal basis for this can be supported by the principle of international law stated in article 32 of the Vienna Convention on the Law of Treaties which provides that preparatory work of the treaty and circumstances of its conclusion are helpful in interpreting the provisions of a treaty.

21 Reuven S. Avi-Yonah & Haiyan Xu, *A Global Treaty Override: The New OECD Multilateral Tax Instrument and its Limits,* 39 Michigan Journal of International Law 155, 156 (2018). These drafts have been recognized for heavily influencing the drafts of model tax treaties developed by the OECD and almost all drafts that came after the second world war. While the OECD built on the London Model, the United Nations built on the Mexico Model.

22 *See*, Yariv Brauner, *Serenity Now! The (Not So) Inclusive Framework and the Multilateral Instrument*, 25 Florida Tax Review 489 (2022), for an extensive discussion on the lack of unified views on the OECD's approach to global tax treaty reform in the MLI, lack of general acceptance of some of the provisions included in the MLI, etc.

23 *Supra* note 12 at 468.

decisions for the company.[24] Unsurprisingly, this only worsened the vagueness associated with the definition of POEM. It led to questions about whether the OECD preferred other approaches to defining POEM such as where the daily management of the company occurred.[25]

In 2008, the OECD also introduced an alternative tiebreaker rule for dual corporate tax residence to the Commentary to the Model Tax Convention (the Commentary). It provided member states with an opportunity to resolve cases of dual corporate tax residence by mutual agreement procedure. However, it was not until 2017 that this amendment was made to the Model and there were a series of events that led to this. The global financial crisis revealed the corporate tax planning of multinational enterprises (MNEs), and how MNEs erode the domestic tax base of several countries and shift profits to low-tax jurisdictions. This situation led to conversations about the morality of the tax planning activities of MNEs. These heavy media criticisms and public debates prompted the OECD to intervene through its base erosion and profit shifting (BEPS) project which had the primary objective of combatting the harmful tax practices of MNEs.[26] In 2015, the OECD released a 15-point action plan to address these issues. Action 6 of its project dealt with preventing the granting of treaty benefits in inappropriate circumstances.[27] One of its objectives was to prevent the exploitation of the POEM test by MNEs and to instead adopt an approach of having the competent authorities of contracting states decide cases of corporate tax residence. It was this conclusion that led to its amendment of the Model in 2017. As it was making changes to the Model, the OECD began working on the MLI to make changes geared at preventing tax treaty abuse. In addition to requiring that competent authorities endeavour to resolve cases of dual corporate tax residence by mutual agreement, the MLI also denied treaty benefits to such companies until a resolution has been reached.[28]

As our examination of the historical evolution of the tiebreaker rules for companies has shown, although the jurisprudence of tiebreaker rules for tax residence of companies has been evolving with minor modifications every now and then, the rule has remained largely unchanged for the past century of active global tax treaty policy making. The BEPS project, and subsequently the MLI, represented the first radical change to the tiebreaker rules for corporate residence in close to 100 years. While there are still scholarly debates about the efficacy of the MLI to address the challenges identified in action 6 of the BEPS

24 Lidija Zivkovic, *Resolution of Dual Residence Instances in the Case of Companies,* 2020 Annals of the Faculty of Law in Belgrade-International Edition 111, 117 (2020).

25 *Ibid.*

26 Daniel Olika, *Tax Morality: Examining the BEPS Debate, Work of the OECD and Its Impact on Africa,* 11 Pretoria Student Law Review 89, 90 (2017). In response to questions about the morality of their actions, MNEs often replied that their actions were not illegal. This has led to debates on the conflict between morality and legality in the tax planning of MNEs. *See* also, Hella Ebrahimi, *Starbucks, Amazon and Google accused of being "immoral"*, The Telegraph (Dec. 12, 2022, 11:57AM), https://www.telegraph.co.uk/finance/personalfinance/tax/9673358/Starbucks-Amazon-and-Google-accused-of-being-immoral.html.

27 *Ibid*, at 99.

28 Article 4, paragraph 1 of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting.

project,[29] the current wording of the tiebreaker rules represents the latest position of the OECD on resolving cases of dual corporate tax residence. We shall now examine this new change to tiebreaker rules of dual corporate tax residence in tax treaties.

3. Tiebreaker rules for corporate tax residence under the MLI

The main MLI provision dealing with dual tax residence of companies can be found in article 4 paragraph 1 which provides as follows:

> Where by reason of the provisions of a Covered Tax Agreement a person other than an individual is a resident of more than one Contracting Jurisdiction, the competent authorities of the Contracting Jurisdictions shall endeavour to determine by mutual agreement the Contracting Jurisdiction of which such person shall be deemed to be a resident for the purposes of the Covered Tax Agreement, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by the Covered Tax Agreement except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting Jurisdictions.[30]

The provision is self-explanatory. It essentially seeks to provide a regime where issues of dual tax residence of companies are resolved not by any rule, such as; POEM or place of incorporation, but by mutual agreement procedure (MAP) between the competent authorities of the contracting states. It however notes that the competent authorities are to consider these rules and any other relevant factors in deciding on the tax residence of companies. The second paragraph of this article also reinforces that this provision is to apply as the tiebreaker rule for corporate tax residence or replace such tiebreaker rules. Paragraph three of the article also provides for different reservations that countries can make to the implementation of this provision in their tax treaties.[31] These reservations range from the non-application of the provision altogether to its non-application when a country already has either a mutual agreement procedure or denial of treaty provision in place for the resolution of cases of dual tax residence for companies.

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29 *See,* Nathalie Bravo, Is the Multilateral Instrument Really Multilateral? In Multilateral Convention for Tax-From Theory to Implementation, 89 (S.A. Roche and A. Christians ed., Wolters Kluwer, Series on International Taxation, 2021).

30 Article 4, MLI.

31 This provision has been inserted in article 4 and other articles of the MLI where no consensus was reached to provide countries with the option not to implement a particular provision in their tax treaties. Some scholars have argued that the presence of this provision in the MLI is a weakness in that it will push parties further away from coordination which is one of the main objectives of the BEPS project. *See*, Joseph Morley, *Why the MLI Will Have Limited Direct Impact on Base Erosion and Profit Sharing*, 39 Northwestern Journal of International Law & Business, 225 (2019).

3.1. Negative Reception of the MLI's Tiebreaker Rule

In commenting on this provision of the MLI, while several reasons have been adduced for benefit of this provision and its importance,[32] the focus of this section of the paper is to show the limitations of this provision. Thus, we start out by noting that notwithstanding the advantages of this provision identified in the literature, it has also been the subject of intense criticisms right from when it was introduced under the BEPS action plan 6. Unsurprisingly, it has generally not been well received even by countries that have signed the MLI. As of November 30, 2022, 100 countries have signed the MLI. Out of these countries, sixty countries have opted out of the application of this provision of the MLI altogether.[33] Furthermore, three countries opted out of this provision on the basis that they had adopted the MAP in their tax treaties,[34] two countries opted out on the basis of provisions in their tax treaties denying treaty benefits in cases of dual tax residence of companies,[35] four countries opted out on the basis that they had MAP in their tax treaties as well as provisions on how the company is to be treated in cases of dual tax residence,[36] and one country opted out of the provision of article 4 paragraph 3(e) which reserves the right to provide total denial of treaty benefits.[37] While these numbers can easily change at any time, they are reflective of the current attitude towards the implementation of this provision in the MLI. They are a great representation of the fact that even for countries signed to the MLI, they do not intend to adopt the new tiebreaker rules. Notwithstanding the current attitude towards this provision, we find that it will continue to feature in the tax treaty conversation on resolving dual tax residence of companies and may possibly begin to be applied in the future.

3.2. The MAP Tiebreaker Approach

Beyond the lack of widespread acceptance of this provision, the first issue with the general wording of this provision in the MLI is the adoption of the MAP as a tiebreaker rule. The provision represents the OECD's position that it intends for instances of dual tax residence of companies to be resolved on a case-by-case basis.[38] In terms of approach, the provision notes that the competent authorities of the contracting states "shall endeavour" to determine by MAP the

32 *See,* Annet Wanyana Oguttu, *Should Developing Countries Sign the OECD Multilateral Instrument to Address Treaty-Related Base Erosion and Profit Shifting Measures?* CGD Policy Paper, (Dec. 13, 2022, 11:11AM) https://www.cgdev.org/sites/default/files/should-developing-countries-sign-oecd-multilateral-instrument-address-treaty-related.pdf.

33 OECD, *MLI Database-Matrix of Options and Reservations,* OECD (Dec. 13, 2022 10:10AM) https://www.oecd.org/tax/treaties/mli-database-matrix-options-and-reservations.htm.

34 *Ibid*. This is further indicative of the lack of acceptance of this provision in tax treaty practice of countries in that only 3% of countries were willing to opt out of the MLI provision because of acceptance of the procedure in their tax treaties.

35 *Ibid.*

36 *Ibid.*

37 *Ibid.*

38 It appears that the OEEC, the predecessor organization to the OECD, had first recommended this approach in the 50s when it started working on tax treaties but it was subsequently removed from the final draft convention it released. *See, Lidija,* pp. 118-119.

contracting state in which the company shall be deemed to be resident. The clear choice of language here is indicative of the fact that there is no obligation on the contracting states to resolve the dual tax residence situation that has arisen. Thus, without an obligation to resolve the dual tax residence cases that arise, the contracting states may easily leave the tie unbroken. The provision basically confers a discretionary power on the tax authority to resolve the situation[39] and therefore does not provide for certainty in its application. It does not take much to conclude that this approach is very ineffective and undoubtedly would lead to cases of double taxation where companies are deemed to be resident in two different countries under a treaty. This defeats the application of the treaty to companies and may be a roundabout way of suggesting that either the OECD is unable to provide a more effective rule in place of the current one or that it is more concerned about preventing the possibility of double non-taxation of companies than preventing the double taxation of companies.[40] Generally, the argument has been made that despite its inefficacy, this rule is more likely the policy favourite because of the current norm in the international tax world.[41] The approach also leans closely towards not recommending any tie-breaker rule for companies and suggesting that dual resident companies are to be taxed doubly, and this is an approach that is also represented in some bilateral double tax treaties in the world today.[42] The basis for adoption of this approach would be because of its tendency not to be exploited or manipulated. Notwithstanding, a tax rule's lack of susceptibility to be exploited does not mean it is effective and does not justify its adoption,[43] especially when the applicability of tax treaties depends on it.

In terms of the procedure for initiating the MAP, the OECD notes in its Commentary that the taxpayer has the obligation to initiate the MAP where it believes it would be dual resident under the tax treaty by following the procedure in article 25 of the OECD Model.[44] The taxpayer is also to initiate this within a particular timeline failing which the competent authorities do not have the obligation to act. This highlights another shortcoming of this approach in that the lack of clear timelines on the resolution of this dual tax residence issue may keep the taxpayer in a limbo regarding the application of the treaty for a long time.[45] This situation is worsened by the fact that article 25 of the OECD Model which deals with MAP has no clear timeline for resolving issues arising from the interpretation of the treaty. This failure also makes the need for the application of provi-

39 *The Competent Authority Concept in United States Tax Treaties,* 2 Law and Policy in International Business, 232, 241 (1970).

40 This is more likely the case especially when one considers that the MLI resulted from action 6 of the OECD BEPS project seeking to deny treaty benefits in cases of tax avoidance of MNEs and action 2 which sought to prevent the hybrid mismatch arrangements that were made possible in part by dual tax residence of companies.

41 *Brauner supra* note 9 at 998.

42 Dennis L. Zakas, *Dual Residency and Double Taxation of Individuals and Corporations under the 1980 United States-United Kingdom Income Tax Treaty,* 21 Virginia Journal of International Law, 555, 576 (1981).

43 David Elkins, *The Sanford E. Sarasohn Conference on Critical Issues in Comparative and International Taxation II: Taxation and Migration: The Elusive Definition of Corporate Tax Residence,* 62 St. Louis University Law Journal 219, 221-224 (2017).

44 *Supra* note 10, para. 24.2

45 Cosima Gerlach and Nicola Niemeyer, *The New Tie-breaker-Rule for Companies According BEPS Action Point 6: A (Too) Radical Change*, 46 Intertax 753, 760 (2018).

sions on arbitration more necessary to resolving treaty disputes.[46] Unfortunately, arbitration was not made mandatory under the MLI.[47]

Another limitation to the MAP tiebreaker approach is that despite the lack of obligation or timelines for the competent authorities to act, article 4 of the MLI restricts the application of treaty benefits to the taxpayer where the competent authorities are unable to resolve the situation of dual tax residence. This provision seems punitive in that the taxpayer bears the brunt of a failure of the competent authorities to act and it is unfair to the taxpayer considering that the same provision does not make it mandatory for the competent authority to act. It is not good tax policy because it is not all cases of dual tax residence that are motivated by tax avoidance. Although for countries with a foreign tax credit or exemption system under domestic law, the impact of this on companies may not be as huge compared to countries that rely on tax treaties to provide relief for double taxation. Furthermore, in situations where a dual tax residence would have arisen innocently, it deviates from the core purpose of tax treaties which is to provide relief from double taxation.

Overall, the lack of certainty and procedural inefficiency associated with this tiebreaker approach does not seem to have contributed positively to the situation with dual corporate tax residence that was created by the shortcomings associated with the POEM rule.

3.3. The Uncertain Legal Standard

In a rather curious fashion, the language of the MLI requires that competent authorities in attempting to resolve the dual tax residence of companies are to adopt the POEM, place of incorporation and any other relevant factor. Clearly, this phrase is riddled with uncertainty for the taxpayer as well as the competent authorities. In summary, the OECD went from canvassing for the POEM rule for decades and after intense criticisms of the rule, basically said; cases of dual tax residence should now be resolved by the competent authorities by applying rules that have been characterized as ineffective and other factors the competent authorities may wish to consider. As noted earlier in this paper, uncertainty and unfairness in this manner does not augur well for both the application of the rule and for the taxpayers who may be subject to its application where it is adopted.

The inclusion of the POEM rule is problematic because listing it as a factor in light of the acknowledgment of its inefficacy in modern times, due to —amongst other things— mobility issues,[48] and its susceptibility to manipulation, shows that the OECD has not introduced anything pragmatic or original in terms of resolving dual tax residence in the MLI. Asking contracting states to still apply

46 *See,* William W. Park, *Income Tax Treaty Arbitration*, 10 George Mason Law Review, 83 (2002). *See* also; Daniel Olika & Ilemobade Olateru-Olagbegi, *Assessing the Transfer Pricing Disputes Framework in Nigeria,* 43(2) Business Law Review 65 (2022).

47 *See,* OECD, Action 6- 2015 Final Report, 91-93.

48 Eva Burgstaller and Katharina Haslinger, *Place of Effective Management as a Tie-Breaker-Rule-Concept, Developments and Prospects,* 32 Intertax 376, 382 (2004).

the POEM rule is indicative of the general helplessness as to the most effective way to resolve dual tax residence of companies. This is complicated by the rather curious inclusion of the place of incorporation rule to the list of factors competent authorities are to consider. This rule had been disregarded by the OECD in the past[49] and one wonders what the justification for its inclusion is at this time.

Furthermore, the MLI enjoins contracting states to apply "other relevant factors" to the resolution of dual tax residence. This begs the question, what are the other relevant factors? In the absence of any guidance or universal agreement on this point, this rule, if adopted, is going to lead to uncertainty in its application. Taxpayers faced with a situation are bound to be unsure of what the outcome of the MAP would be because they are unsure what rule the contracting states would be applying in any given situation.[50] The competent authorities are also bound to suffer the same uncertain fate as they are bound to be unsure what factors to apply. Where different countries approach the issues differently, it is bound to also complicate the MAP tiebreaker approach.

Another issue presented by the MLI’s position is uncertainty as to the order in which the proposed tests are to be applied. By enjoining contracting states to apply the POEM, place of incorporation and any other relevant factors; is the OECD suggesting that they are to be applied concurrently or just one of them is to be applied or the rules are to be applied a hierarchical order?[51] It would appear that the preference of the OECD is that there should be a concurrent application of these factors at the same time to determine which one of them helps to answer the question of where the company should be deemed resident. But it is worth noting that without providing a hierarchy to their application, a contracting state faced with a question of resolving dual tax residence may therefore choose any factor it so wishes that is possibly not even listed since it has no obligation to follow either the POEM or place of incorporation rules.

We are forced to ask ourselves, have we considered all possible options for resolving dual tax residence that may exist? The next section of this paper seeks to look into this issue.

4. Is there a way forward?

4.1. Is There an Alternative Rule Worth Considering?

The idea of determining the residence of a company —subject to the taxing-powers of two different countries— based on where it is resident, has evolved

49 *Supra* note 45 at 761. Apparently, the rule had first been introduced by the OEEC in discussions in the 1950s leading to the preparation of its draft but was subsequently deleted from the final work that was produced at that stage.
50 *Ibid*.
51 *See*, *supra* note 45, for an extensive discussion of the possibility of a hierarchical rule in relation to resolving dual tax residence of companies. The application of a hierarchical rule appears to be enjoying continuous positive reception in relation to individuals.

from theeconomic allegiance theory canvassed by the four economists.[52] Their argument at the time was simple but produced the rather interesting POEM rule that has failed to effectively lead us to the economic allegiance of companies for decades. They argued that where the center of management is located is the best possible solution to ascertaining where the company owes its economic allegiance,[53] but there is reason to believe that this is not necessarily the case. Are there other options that can be helpful in ascertaining the so-called economic interest of the companies? This question becomes important in light of the criticisms to the MLI identified in the preceding section. The first part of this section attempts to provide an answer by looking closely to a line of thought that is often disregarded for being too difficult.

It is noteworthy that the MAP approach does not align with the foundational tiebreaker approach identified in the work of the four economists which was grounded in the application of the economic allegiance theory to resolving cases of dual tax residence. The four economists had argued that the dual tax resident company is to be deemed to be resident in the country where it owes its economic allegiance.[54] In seeking to ascertain how this determination may be made, they had eschewed any political allegiance approach to be found in the place of organization or incorporation of the company. Clearly such an approach would be ineffective and could easily be manipulated for tax avoidance purposes. The four economists however believed that the approach that best reflects the economic allegiance theory was an earlier version of the POEM as identified in the second part of this paper. They believed that having a company resident where its managers meet represents the best approach since this is reflective of how value is created for the company.[55] Their argument was that wealth is produced not merely by the "community of economic life" which facilitates it but also by the human relations which contribute to this.[56] By so doing, they were invariably prioritizing entrepreneurship as the most important factor of production for the purpose of creating value and making a company resident where value is created, i.e. where the managers meet. It is noteworthy that this may not have represented the best approach for two main reasons. First, the four economists conceded that the limitation of the POEM (and we could argue of prioritizing entrepreneurship for deciding the location of value creation of the company) is that management is mobile, and managers may run a company from a distance. This point does not warrant further elaboration because if it was true in the 1920s, the ramifications to the truth of this point are innumerable today. Second, it seemed to have represented the prevailing economic thought of the late nineteenth and early twentieth century that entrepreneurship is the most important factor of production for the purpose of creating value.[57] Apart from the fact that the issue of what factor of production is the most important was a subject of scholarly debate, making this test dependent on one factor with an obvious limi-

52 *See, Supra* note 12 at 462.
53 *Supra* note 13 at 21.
54 *Ibid*.
55 *Supra* note 13 at 23.
56 *Ibid*.
57 *See,* Philip A. Klein, *Changing Perspectives on the Factors of Production,* 22 Journal of Economic Issues, 795 (1988).

tation like mobility,[58] negates the need of determining where the company is fixed, and was therefore not the best approach. Thus, they could have been wrong, as decades of treaty practice has shown, to have suggested this approach as the best way to ascertain where a company owes its economic allegiance.

In light of the above identified limitations, perhaps a better approach is to consider where the most value is created between two contracting states would be an aggregation of the factors of production of the company in both states, then determining where the company uses the most factors as where it is resident. A similar test appears to have been considered by the OECD in the past which it referred to as the economic nexus test.[59] This would be consistent with emphasizing that different factors of production are responsible for creating economic value and it is not always the case that one factor is the most important to a company for the purpose of creating value. Thus, aggregating this will always produce the best-case scenario as opposed to relying on just one factor.

Ultimately, the connection between a company and any country is only an economic one.[60] In cases of dual tax residence, as between two contracting states, where the company derives more economic value should therefore be used to justify the application of a tax treaty to determine who taxes this economic value. Bearing in mind that the treaty can provide relief for double taxation that may occur, risks associated with double taxation of profits or taxation of foreign sourced earnings in this situation are reduced. The OECD, by listing POEM, place of incorporation and other relevant factors, already admits that an aggregation of various factors[61] is to be considered for resolving dual tax residence. Thus, bearing in mind that the OECD already tacitly recognizes that no one factor is more important than the other, adoption of an approach that considers all the possible factors that can lead to that resolution of dual tax residence is more likely to produce a true reflection of where a company is resident at all times. The aggregation of economic interest, therefore, warrants a closer attention as a tiebreaker rule.

The limitations of an approach that seeks to aggregate the economic factors of value creation for the purpose of deciphering a company's tax residence is not without its difficulties. First, doing so will not align with the view of the OECD which prefers a residence-based taxation to a source-based taxation.[62] Second, surely, such an approach will face valuation problems when value is to be compared for the factors of production used between two countries with different economic systems. Notwithstanding, a thought to consider may be to ascertain how the aggregate factor interacts with the economic value or profit generated, or states may consider a set of tests that helps to reach this conclusion and negotiate these tests into their treaties. This is important because despite its limitations and the problems it poses, determining true economic allegiance is better approached by considering the multiple factors that help to create the

58 It is unsurprising that the rule bears no relevance in the twenty-first century world.
59 *Supra* note 5 at 45.
60 David Elkins, *The Myth of Corporate Tax Residence*, 9 Columbia Journal of Tax Law, 5, 23 (2017).
61 Although not economic factors. From the suggestion of POEM, place of incorporation, and any other relevant factor; it would appear that the OECD is looking at formal and substantive factors.
62 *Supra* note 5.

value as opposed to prioritizing any one factor above the others or adopting a formal approach like place of incorporation that tends to have no bearing on the economic outcome of the company's activities.

4.2. What Can Be Done to Improve the MAP Tiebreaker Rule in the MLI?

At the end of the day, because deciding who to tax is within the exclusive preserve of a contracting state and an issue of sovereignty, tax treaties cannot define residence.[63] The role of the tax treaty with respect to defining residence is therefore to prevent double taxation by breaking the tie when a company qualifies as a tax resident of two contracting states. The position the OECD has established with the MLI suggests that for companies where it is already difficult to use any one factual determinant to determine with precision where they are resident –and to prevent such factual determinants from being exploited by companies– it is better to leave the tiebreaking to the competent authorities of both states. As presently constituted, this rule is fraught with many challenges. The preceding section of this paper was devoted to identifying such challenges. Admittedly, the alternative identified in the preceding section of this paper is not an easy one. Thus, this subpart seeks to propose areas of improvement for the current position in the MLI.

First, with regards to the application of the MAP tiebreaker, the OECD needs to provide guidance on many procedural issues. The uncertain timelines for the resolution of the dual tax residence does not show good tax policy. It is recommended that a timeframe be proposed to prevent this process from going on forever while the company involved continues to suffer from double taxation.[64] Additionally, the competent authorities should be mandated to resolve this issue as opposed to being provided with a discretion as to whether to resolve a case of dual tax residence or not. As noted above, while the justification for the adoption of this approach may have been to prevent dual tax residence, given the possibility of a company being dual resident under a treaty due to no fault of the company, this warrants a revision. Additionally, the option of arbitration needs to be provided in the treaty to simplify the process and provide companies with an opportunity to decide whether to pursue an arbitration procedure or the MAP.[65] If the OECD is keen on proceeding with the case-by-case analysis as opposed to designing a rule, then this has a higher potential of success.

Second, the tests or standards to be considered by the competent authority in resolving dual tax residence need to be stated precisely. This is extremely important to prevent inconsistencies in their application. It may also be prudent

63 This is buttressed by the fact that the tax treaties do not attempt to define who a resident is but subject that determination to whoever or whatever falls within the complete taxing powers of a state. Thus, it is left for the states to decide how to arrive at that conclusion. To do otherwise would be akin to making the domestic tax laws of contracting states through tax treaties.

64 Some scholars have recommended that the timeframe be restricted to six months. *See*, *supra* note 5 at 760.

65 *See,* M. Zuger, *Conflict Resolution in Tax Treaty Law*, 30 Intertax 342 (2002).

to consider the creation of a safe harbour rule for the application of the MAP tiebreaker and denial of treaty benefits rule, to protect smaller companies who may be affected by the application of this rule.

5. Conclusion

The work of the OECD on the MLI represents the first significant change to the tiebreaker rules for dual tax residence in close to 100 years. In the final analysis, it is clear that the position in the MLI appears to be more concerned about preventing double non-taxation than actually breaking the tie of dual tax residence, and by so doing preventing a case of double taxation. Whether this rule is effective or not is going to have an impact on the free flow of capital. Where it is not, it would negate the idea of the creation of tax treaties for companies who are caught up, innocently or not, in the web of dual tax residence. Furthermore, it is worth noting that the approach adopted by the MLI is a clear deviation from the economic allegiance theory that underpins the resolution of dual tax residence from the early days of tax treaties. Unsurprisingly, even among countries that have signed the MLI, this MAP tiebreaker rule and denial of treaty benefits have not been positively received. It is doubtful whether, unless the rule is significantly modified, the situation will change with respect to countries choosing to adopt the MLI's approach to breaking the tie of dual tax residence in the future. If this MLI rule were to be adopted as currently designed, then a lot is hanging in the balance on the applicability of tax treaties to companies in the future. It is akin to saying tax treaties are for individuals and not companies, unless of course a company has just a single tax residence under the tax treaty.

This opportunity to resolve a perennial issue of resolving dual tax residence of companies by the OECD appears to have left more to be desired. We hope that this is not the last stop in the evolution of the tiebreaker rule for dual tax residence of companies. At the earliest opportunity for revision, it is hoped that the OECD revises its current position to make the tiebreaker rule more effective and reflective of the economic allegiance theory that underpins the resolution of dual tax residence of companies.