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CHANGING RESIDENCE AS TAX PLANNING

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Changing residence as tax planning

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1. INTRODUCTION.

It is well know that in 1923 the Financial Committee Report prepared for the League of Nations by the so called four economists, under the leadership of Edwin R.A. Seligman[1] concluded that economic allegiance between income and the taxing state is the basis of tax jurisdiction. Criteria as varied as residence, nationality, domicile, and source were at this moment discussed as being indicative of economic allegiance, but nowadays residence of individuals and legal entities is the most important connecting factor in allocating the jurisdiction to tax, in both domestic law and tax treaties.

But for the definition of residence -due to their legal traditions, historical factors, etc.- different countries use in their tax laws elements that, although partially interchangeable, may be somewhat different. These differences might produce conflicts of double residence, because two countries could concurrently treat an individual or a company as a resident for tax purposes with the consequence that both would claim worldwide income taxation. Alongside this, tax arbitrage and tax planning may arise because of the remarked differences, and besides significant non-tax consequences there are noteworthy advantages mostly related to income and inheritance taxes[2].

International tax competition contributes to enhace this scenario due to great capital mobility, withholding taxation removal by many developed countries and the emergence of new preferential tax regimes, but also due to the failure on tackling tax havens. These factors that may be relevant for individual taxation purposes, are even

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[1] It has become a commonplace to attribute to this Report the key role in fashioning the modern international tax regime; see AVI-YONAH, R.S. "The Structure of International Taxation: A Proposal for Simplification", in *Texas Law Review* vol. 74, 1995-1996, pp. 1305 ss.

[2] Because sometimes the same concept of residence is used for income, wealth and inheritance tax purposes; see RUST, A. "The Concept of Residence in Inheritance Tax Law", in MAISTO, G. (ed.) *Residence of Individuals under Tax Treaties and EC Law*, IBFD, Amsterdam 2010, p. 87.

more critical in company taxation. Indeed, competition for inbound investment has led an increasing number of countries to offer reductions in their effective tax rates (or even the so called "tax holidays") to foreign corporate investors[3]. And given the relative ease with which multinational groups can relocate their tax residence -if not their production facilities- in response to tax rates, such tax competition enables multinationals to obtain most of their income free or with a very low taxation.

For this reason, residence is a matter of considerable importance, and it will likely continue to be of the utmost importance, as personal and economic activity becomes increasingly mobile. And as residence electivity[4] is also relevant for tax planning purposes -for individuals[5] and companies- I will try in this article to analize the role that changes in residence plays in tax planning and how different countries are trying to act in this respect, developing first some considerations regarding the role and meaning of the concept of residence (2), that will allow us to point some tax planning opportunities derived from asymmetries regarding the residence definition by domestic tax laws in different countries. We will then pinpoint those strategies and their risks by analyzing some case law and other cases that are in the center of the public debate (3). This kind of tax planning schemes, which are normally the result of state's competition in the tax arena, are also the basis for the development of defensive measures, *i.e.* residence concept enlargement or exit/expatriation taxes. The study of these measures will probably confirm that to counteract tax planning related with residence through these anti-abuse provisions may cause other residence related concerns (4) and thereby plead for other kind of measures that could better help tax administration in achieving their tasks.

2. SOME REMARKS ON THE CONCEPT OF TAX RESIDENCE.

As stated, residence is the most spread connecting factor to determine worldwide income taxation in a certain country, regardless income source. It is a

[3] See AVI-YONAH, R.S. "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State", in *Harvard Law Review*, vol. 113, 2000, pp. 1576 y 1579 ss.

[4] See SHAVIRO, D. "The Rising Tax-Electivity of U.S. Corporate Residence", *Tax Law Review* vol. 64, 2011, pp. 377 ss.

[5] As indicates that the IFA devotes its 2002 Congress to the topic; see IFA *The Tax Treatment of the Transfer of Residence by Individuals*, Cahiers de Droit Fiscal International, vol. LXXXVIIb, Kluwer, The Netherlands 2002.

reasonable parameter to establish a link between a person and a tax system and a standard not only among OECD members but also adopted by countries that traditionally rejected it; therefore the use of other criteria -vgr. nationality[6]- is exceptional at the present time[7].

This probably occurs because residence is a connecting factor that can reflect a relatively substantial and intimate relationship between a country and a person, depending on the precise concept being employed, even if in the case of companies residence might be viewed as somewhat artificial[8].

We should set aside the analysis of domestic law criteria[9] to focus on some general remarks on this connecting factor.

In this sense, it is relevant to stress that in the area of taxation the different treatment of the basis of residence parameters is the rule rather than the exception. The use of permanence criteria, the center of vital interests, domicile or disposal of a habitual abode; the place of incorporation, the legal seat of a company or the place of effective management for legal entities illustrates this reality. To put it in other words, although residence is nearly the only criterion that exists to allocate the jurisdiction to tax on worldwide basis, a considerable diversity exists on the elements used to its determination which are built by countries on a self-determined, uncoordinated basis[10]. Probably, this is the reason why Art. 4(1) of the OECD Model Tax Convention on Income and on Capital (OECD MTC hereinafter), defines residence not by reference to the circumstances which determines it -that should be established by the domestic

[6] Which is still used by the US, see VACOVEC, Kenneth .J. and BEUTLER, Todd M. "United States", in IFA *The Tax Treatment...* cit., pp. 597 ss.

[7] CALDERÓN CARRERO, J.M. *La doble imposición internacional y los métodos para su eliminación*, McGraw-Hill, Madrid 1997, pp. 27-28.

[8] NIKOLAKAKIS, A. "Civil Law and Common Law Perspectives: A View from the Left", in MAISTO, G. (ed.) *Residence of Individuals...* cit., pp. 76-77.

[9] In addition to the references that one can find in the IFA Branch Reports, in IFA *The Tax Treatment…* cit., pp. 97 ss.; and in IFA *Source and residence: new configuration of their principles*, Cahiers de Droit Fiscal International, vol. 90a, Kluwer, The Netherlands 2005, pp. 58 ss. and the Branch Reports; see for individuals the Country Reports in MAISTO, Guglielmo (ed.) *Residence of Individuals...* cit., pp. 197 ss.; and for companies the Country Reports in MAISTO, Guglielmo (ed.) *Residence of Companies under Tax Treaties and EC Law*, IBFD, Amsterdam 2009, pp. 311 ss.

[10] CALDERÓN CARRERO, José Manuel. *La doble imposición...* cit., p. 28.

law of each state- but by the effect it produces, i.e. the liability to tax on a worlwide basis[11].

In any case, from a theoretical point of view the concept of residence should be equitable, administrable and difficult to manipulate[12]. From an equity perspective, unlimited taxation on residents has been justified by the ability to pay principle, particularly in relation to income taxation of individuals, because equity -whether horizontal or vertical- is best satisfied by the unlimited taxation of residents since it affords equal treatment by law regardless of where income is derived from[13]. The relationship between residence and the ability to pay principle has been criticized as the latter does not indicate which part of the income earned in a cross-border situation can be taxed in the residence state and which part in the source state. But even if one has to share this criticism, because the unlimited taxation of residents is better justified by the benefits principle, if we take into account the actual or potential benefits that the taxpayers attain from government-supplied goods and services[14], it seems to be truth that circumstances that give rise to residence ascertainment should be consistent with both principles. In other words, besides Art. 4(1) of the OECD MC permit a wide field for countries to establish circumstances which define residence, those criteria cannot be random selected as it is necessary to consider exclusively the state with which a taxpayer maintains the stronger attachment from the benefits principle perspective, and thus the one that has the best position in order to take into account its ability to pay.

Besides the ability to pay principle does not play any role within the determination of the extent to which each state may levy tax in a cross-border transaction, it is truth that the residence state is especially legitimated to take into account the whole income obtained by a person -including foreign source income- to properly quantify a concrete tax, both because equity reasons and because the

[11] WHEELER, Joanna "The Missing Keystone of Income Tax Treaties", in *World Tax Journal*, vol. 3, 2011, p. 251; in this sense OECD *Addressing Base Erosion and Profit Shifting*, OECD Publishing 2013, p. 34 states that "Residence, for treaty purposes, depends on liability to tax under the domestic law of the taxpayer".

[12] RUST, A. "The Concept of Residence..." cit., p. 85 ss.

[13] See SCHINDEL, Angel and ATCHABAHIAN, Adolfo "General Report", in IFA *Source and residence: new configuration of their principles*, Cahiers de Droit Fiscal International, vol. 90a, Kluwer, The Netherlands 2005, pp. 31 ss.

[14] MÖSSNER, Manfred "Source versus Residence – and EU Perspective", in *Bulletin for International Taxation*, vol. 60, 2006, p. 505.

residence of individuals overlaps to some extent with their political allegiance, a factor that links tax levies with the non taxation without representation principle, one of the main pillars for the rule of law in tax matters.

In addition, the concept of residence should be administrable, i.e. criteria for its determination should be clear in order not to produce excessive conflicts in its practical application. From this point of view, residence-based taxation makes sense for individuals, since residence is relatively easy to determine in the case of individuals; most individuals are part of only one society, and residence overlaps with political allegiance, beeing a proxy for taxation with representation[15]. Indeed, even if there are some difficult cases, residence of individuals can be defined on bright-line rules, such as a number of days of permanence -the so called 183-day test- some individual facts and circumstances test -domicile, home, centre of family or economic interest- or other specific criteria such as engagement in government services, diplomatic activities, etc. Despite all the difficulties -which will be analyzed below- the truth is that individuals can only be in one place at any given time, so their residence is a relatively easy concept to establish, specially if we confront the concept of residence with the concept of source, because the definition of the latter amounts to a highly problematic endeavor[16], as the concept of source is in itself controversial due to the lack of connection with the economic reality, i.e. with the facts that give rise to its determination, as in most cases income will have more than one source. Also, it is quite relevant that residence-determining criteria should be easy to manage, i.e. in a cross-border situation, the current as well as the former residence countries dispose of the necessary information to asses the tax base and to collect the pertinent tax revenue.

Things are quite different on legal entities residence matters, not only because the justification of residence taxation of companies gives rise to many difficulties[17] but also because it is quite complicated to specify criteria that could be properly managed for the tax residence to be determined. From this point of view, residence of

[15] AVI-YONAH, Reuven S. “Tax Competition, Tax Arbitrage and the International Tax Regime”, in *Bulletin for International Taxation*, vol. 61, 2007, p. 134.

[16] See for a further development on this arguments AVI-YONAH, Reuven S. "The Structure of International…” cit., pp. 1311-1312; and SCHINDEL, Angel and ATCHABAHIAN, Adolfo “General Report” cit., pp. 31 ss.

[17] AVI-YONAH, Reuven S. "The Structure of International…” cit., p. 1313.

companies is a complicated matter as the clash between domestic and tax treaty policies of many states may cause uncertainties, especially within multinational enterprises. Corporations are not individuals, and the awareness of this basic difference is essential in seeking an acceptable rule or set of rules to define their residence. Indeed, companies can be present in different jurisdictions at a time, a fact that increases difficulties in determining their tax residence.

In any case, it is relevant to emphasize that most States use a combination of formal and substantive criteria to determine companies' residence. The formal tests used are either the place of incorporation or the place where the company's registered office -or legal seat- is established; and as substantial test most of the countries determine the companies' residence as the place where the effective management is situated, an all facts and circumstantes test[18]. All these criteria have been criticized as residence of corporations is difficult to establish and relatively meaningless when is based upon criteria such as the place of incorporation, which is formalistic and subject to the taxpayer's control -just as the legal seat criterion-; notwithstanding, residence based on management and control can also be manipulated[19].

From a practical perspective, place of incorporation and legal seat are two residence criteria that have the advantage of simplicity and predictability for taxpayers, tax administrations and tax courts. However, these criteria have been properly criticized as empirical studies demonstrate that the decision whether to incorporate a company or where this should be done, as well as where to situate the legal seat are influenced by tax motives, and so tax planning opportunities or tax avoidance schemes may arise[20]. Moreover, where a country applies a formal test to determine corporate tax residence and that country has a beneficial tax regime certain risks emerge, i.e. companies may be tempted to incorporate companies to enjoy tax benefits but not necessarily a genuine nexus with that country may appear[21]. In this sense, the use of the place of incorporation as a connecting factor is one of the main reasons for the adoption of limitation-on-benefits provisions in an increasing number

[18] DE BROE, Luc "Corporate Tax Residence in Civil Law Jurisdictions", in MAISTO, Guglielmo (ed.) *Residence of Companies...* cit., p. 96.
[19] AVI-YONAH, Reuven S. "Tax Competition..." cit., pp. 134-135.
[20] WEBER-FAS, Rudolph "Corporate Residence Rules for International Tax Jurisdiction: A Study of American and German Law", in *Harvard Journal on Legislation*, vol. 5, 1967-1968, p. 228
[21] DE BROE, Luc "Corporate Tax..." cit., p. 101.

of tax treaties[22]. These provisions are indeed a symptom which evidence that the mere incorporation connection or the legal seat are in themselves not accepted, but the concurrence of other supportive elements are needed in order to claim the treaty protection.

The point is that neither those formal criteria are satisfactory nor the place of effective management serves for these purposes as it requires a case-by-case analysis of all fact and circumstances and thus leaves a wide margin of interpretation to tax authorities and the courts[23]. Even more, the place of effective management is not easy to manage since it demands all the relevant facts and circumstances knowledge, items that will not always be on tax administrations or tax courts hands to properly decide whatsoever.

Lastly a residence concept should be difficult to manipulate, so that residence cannot be easily given up in one country and established in another country or at least it should guarantee that changes of residence do not easily alter an individual or corporation tax regime. From this perspective we have ascertained that the use of formal criteria enables residence manipulation schemes, forcing states to establish restrictions or anti abuse rules that may lead to increase tax law complexity. Aside from such formal jurisdictional approaches may have a tendency to multiply potential situations of double residence that may prompt double taxation scenarios or tax planning opportunities, as we will state below. As formal criteria increase electivity practices by means of place of incorporation and legal seat alterations -specially for start ups-, tougher residence rules on corporation residence matters have been proposed[24]. Moreover, in the Discussion Paper on Taxation of Electronic Commerce, the U.S. Treasury has suggested that "a review of current residency definitions and taxation rules may be appropriate"; even if it is hard to see what definition of corporate residence can be adopted that will avoid these problems[25].

Although manipulation on individuals residence criteria is more complicated, this fact does not mean that issues may arise, specially nowadays as permanence assessment is virtually impossible due to increase mobility and loss of frontier

[22] WHEELER, Joanna “The Missing Keystone...” cit., pp. 294-295.
[23] DE BROE, Luc "Corporate Tax..." cit., p. 102.
[24] SHAVIRO, Daniel "The Rising Tax-Electivity..." cit., pp. 413 ss.
[25] AVI-YONAH, Reuven S. "Globalization, Tax Competition..." cit., p. 1596.

restraints in certain geographical areas. Thus, tax planning opportunities arise and are of great interest on wealth and inheritance taxes, which frequently use a concept of residence similar to the one present in income taxation matters. This is the reason why also in the field of individuals' taxation extension of residence and fictitious residence rules have been enacted to prevent opportunistic changes of residence that may be used to obtain tax advantages, albeit new issues may arise from their application.

Similar considerations could be stated regarding the concept of residence in tax treaties as long as its call for domestic law application, so the diversity of criteria is still present in this kind of scenarios. In this sense, Art. 4(1) OECD MC lists a number of criteria that are typically used in domestic law for defining residence that should be interpreted according with domestic laws rules[26]. This inevitably produces -in addition to double taxation or double non-taxation issues- double residence problems that may be solved by resorting to Art. 4(2) and 4(3) OECD MC, in which a series of tests are introduced in order to assign residence exclusively to one specific state for tax treaties purposes. These conflicts are not easy to solve because despite one assume that a provision intended to solve conflicts arising from differences in the concept of residence in domestic laws should be interpreted independently from these domestic laws, the practice shows that there has been different approaches on tie breaker rules often based or influenced by domestic law[27].

Moreover, the solution to double residence conflicts will be always controversial because it frequently depends on two open and vague concepts, i.e. the centre of vital interests for individuals and the place of effective management for companies. Although other tie break rules for individuals may be less problematic and their application arise fundamentally proof issues, in respect of the centre of vital interest its interpretation is often controversial. Indeed it has been suggested that an individual centre of vital interest should only be determined to be in a particular state if personal and economic relations point clearly towards that state; if any kind of

[26] WIDRIG, Marcel "The Expression "by Reason of his Domicile, Residence, Place of Management …" as Applied to Companies", in MAISTO, Guglielmo *Residence of Companies…* cit., pp. 273-274.
[27] SASSEVILLE, Jacques "History and Interpretation of the Tiebreaker Rue in the Art. 4(2) of the OECD Model Tax Convention", in MAISTO, Guglielmo *Residence of Individuals…* cit., p. 162.

uncertainty remains, the third preference criterion should apply [28]. These considerations are also relevant with regard to the place of effective management, whose implementation poses a lot of problems in complex cases, such as holding companies with an international board that meets in different locations, multinational companies with subsidiaries throughout the world that are in fact very tightly managed from the parent, or finance and royalty conduit companies[29].

In short, residence determination must be performed through domestic law -due to Art. 4(1) reference- by applying heterogeneous criteria whose interpretation by tax authorities and courts may not be identical and inevitably give rise to residence conflicts and tax planning opportunities that must be scrutinized.

3. TAX RESIDENCE AS AN ELEMENT FOR TAX PLANING.

The interaction between independent sets of tax residence rules enforced by sovereign countries may give rise to frictions, including potential conflicts of double residence; but also creates gaps in cases where these interactions lead to double non-taxation. Countries views differ in regard to the definition of residence and circumstances that should be used for its determination. Since wealthy taxpayers everywhere can be expected to try to lower their tax burdens to the minimum, it follows naturally that they -or more likely their tax advisors- will study the rules of individual countries and seek to turn them to their advantage, electing in some way their residence. Hence, the so-called residence "electivity"[30] might be an important element for international tax arbitrage by taking advantage of differences in residence definitions by domestic tax laws[31].

The ability to elect the residence and -as a consequence- its use for tax planning is quite different for individuals than for companies. For the formers, residence is in a certain way a given circumstance that often depends on the place of birth or the parents residence or nationality. To put it in other words, tax planning for individuals

[28] BAKER, Philip "The Expression "Centre of Vital Interest" in Art. 4(2) of the OECD Model Convention", in MAISTO, Guglielmo *Residence of Individuals…* cit., p. 173.
[29] VAN WEEGHEL, Stef "Article 4(3) of the OECD Model Convention: An Inconvinient Truth", in MAISTO, Guglielmo *Residence of Companies…* cit., pp. 305 ss.
[30] In the terms used by SHAVIRO, Daniel "The Rising Tax-Electivity.." cit. pp. 377 ss.
[31] See about residence as an element in tax arbitrage ROSENBLOOM, H. David "International Tax Arbitrage and the International Tax System", in *Tax Law Review* vol. 53, 1999-2000, p. 140.

consists in moving from one country to another, transferring residence and giving place to issues of allocation of taxing powers between the country of former residence (hereafter the emigration country) and the country of new residence (hereafter the immigration country). On the other hand, companies have the opportunity to select their place of incorporation and legal seat, a fact that gives them the opportunity to analyze the tax consequences that may arise from their country election but also to properly locate the place of effective management. Besides, companies may choose to change their residence –and not just from a tax perspective– to move to another jurisdiction both from a direct way or by means of complex restructuring schemes.

3.1.Transfer of residence by individuals and tax planning.

Taking residence as a given circumstance for individuals, its use for tax planning is possible only through the transfer from one country to another. At first glance it appears that the most efficient and easiest way to avoid domestic taxes is simply to leave one jurisdiction and move to another one. This option is more clement for the taxpayer, as this formula would not require sophisticated planning to be implemented. However, in practice, this assumption is not correct, because of the non-tax implications of an emigration, the emotional impact on the taxpayer -and his family- who has to abandon his home and his country (and thus relatives, friends, service clubs, etc.) for mere tax purposes. Furthermore, many practical arrangements have to be made (utilities, phone numbers, address cards, social security, hospitalization, doctors, dentist, etc.) and a change of residence or domicile can have a significant legal impact on, *inter alia*, marital property law, inheritance law, alimony obligations in divorce situations, the legal capacity of children and on laws governing the right of access to children[32].

For this reason, even if nobody can discuss that transfers of residence may also be tax motivated[33], this type of planning seems to be very drastic and radical, since it implies an actual emigration. Hence, this kind of tax planning takes place normally for high net worth individuals, who think not only in terms of income taxation but also in

[32] VAN ZANTBEEK, Anton "Tax-Driven Relocation of High Net Worth Individuals: Where to Run to?", in *European Taxation* vol. 50, 2010, p.196.
[33] DE BROE, Luc "General Report", in IFA *The Tax Treatment of the Transfer...* cit., p. 28.

wealth and inheritance taxes[34]; or for individuals with a high level of income who travel for professional reasons around the world, tipically sportsman and artists. In fact, there are notorious cases to be remarked: the famous german tennis player Boris Becker, whose change in residence to Monaco was characterized as a mere sham, for which he was trialed for tax evasion[35]; the Spanish tennis player Arantxa Sánchez Vicario, whose residence in Andorra was challenged by the Spanish tax authorities who applied the domestic definition of residence[36]; or the opera singer Luciano Pavarotti, a case of dual residence that has been highly controversial[37]. In those cases, the transfer of residence to a tax haven country seemed to be tax motivated because if we take into account their sources of income this kind of taxpayers can easily minimize their tax burden on income and also on wealth tax, which normally follows the residence criteria established on income tax law. But assuming that the transfer of residence is not a mere sham, these kinds of changes on residence are legally indisputable, even if they are strongly rejected by the public opinion[38]. Probably for this reason, some countries have adopted certain defensive measures in order to extent residence time periods for nationals who move their residence to tax havens, measures that rise inevitable issues.

In any case, problems usually appear when changes of residence take place without a proper restructuring on the individual assets. If an available permanent

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[34] See for some examples of high profile expatriates from the United States HALABI, Oz "Expatriation Tax - Renouncing a Tax TReaty, in *Bulletin for International Taxation, July 2012, p. 377.*

[35] An accurate description of the case in the BBC website, http://news.bbc.co.uk/2/hi/europe/2355147.stm (last review September the 5th 2013).

[36] See the Spanish Supreme Court (Tribunal Supremo), 7270/2009 Ruling, November 11th 2009; and VAN ZANTBEEK, Anton "Tax-Driven Relocation..." cit., p. 197. Regarding the application in the spanish case law of the tie breaker rules see NAVARRO IBARROLA, Aitor "Los criterios para dirimir la doble residencia internacional en la jurisprudencia española", in *Quincena Fiscal* nº 9, 2012.

[37] The controverse arised because of the interpretation of the relevant tie breaker rules by the Tax Court of Second Instance, as in rejecting the appeal of the taxpayer the Court disregarded the evidence related with his residence in Monaco, taking into account only the facts and circumstances that linked the singer with Italy. The main reason seems to be that the income-producing activities of the artist would lead to the paradoxical result of an individual not having a domicile and therefore not having any tax liability other than the one arising from his residence in Monaco, where no individual income tax is levied. See ROTONDARO, Carmine "The Pavarotti Case", in *European Taxation* vol. 40, 2000, p. 388.

[38] Verb. reactions in the case of Gerard Depardieu, a french actor who balked at France's 75% millionaires tax -finally blocked by France's Constitutional Council- announced a move to Belgium and then Russia, where it was granted him citizenship. The french Prime Minister has stated that he find Depardieu behavior miserly (in French minable) starting a heavily debate about the so called "tax exiled"; see WOOD, Robert W. "New 'Tax Residence' Means Moving (Just Ask Gerard Depardieu)", in Forbes webpage, in http://www.forbes.com/sites/robertwood/2013/03/05/new-tax-residence-means-moving-just-ask-gerard-depardieu/ (last review on September 5th 2013).

home and sources of income remain in the emigration country, tax authorities could use these facts as an evidence to prove that the individual still maintains its residence in that country. That is the reason why double residence conflicts arise, and the solution uses to be uncertain and may not always be based on tiebreaker rules or a proper interpretation of it.

Although changes in residence are surrounded by relevant non-tax implications and may constitute a radical measure, many other different routes can be followed to minimize individuals tax burden depending on the jurisdictions involved, specially in wealth, inheritance and gift taxes. In this sense, assets can be reallocated to another jurisdiction to avoid double taxation[39], wealth can be reorganized to be invested in tax-favored assets, or could be transferred to low-taxed entities if CFC rules in the residence country do not affect individuals. Anyhow, for income tax purposes the possibilities for reducing the tax burden are much lower, despite certain regimes that in combination with other jurisdictions rules may produce striking results.

In this respect, in the United Kingdom and Ireland[40], a person who is resident but not domiciled there is typically subject to tax only on income from sources within that country; while foreign source income is taxable merely if it is remitted into the country[41]. This tax regime has been in the center of the political debate but despite the proposals for its reform, the fact is that is still in force and attracts to the United Kingdom new taxpayers, converting this country in a sort of tax haven under the cover

[39] This result is often achieved in the area of income taxation because of the large tax treaty network that ensure, in most cases, the elimination of any double taxation. However, in respect of gift and inheritance taxes, international double taxation often occurs, because each country has its own criteria in levying inheritance taxes (for example, residence of the deceased, residence of the heir, nationality of the deceased and location of certain assets), which do not take into account the criteria of other countries. As a result of the differing criteria for levying inheritance taxes, which are also applied differently by each country, double or even triple taxation can easily occur; see VAN ZANTBEEK, Anton "Tax-Driven Relocation..." cit., p. 197.

[40] And also in Japan, Singapore and Switzerland and other countries with the intention of attracting Mobile skilled labour; see DIRKIS, Michael "The Expression "Liable to Tax by Reason of His Domicile, Residence" Under Art. 4(1) of the OECD Model Convention", in MAISTO, Guglielmo. (ed.) *Residence of Individuals…* cit., pp. 147-148. The last country in to enact a similar regime has been Portugal by Decree-Law nr. 249/2009, of September 23, for non-habitual resident individuals. The regime would be granted to individuals who became resident for tax purposes in Portugal without having had this status in the five years preceding its acquisition, and would apply for a ten year period.

[41] See DE BROE, Luc"General Report", in IFA *The Tax Treatment of the Transfer...* cit., p. 25.

of the European Union[42], even after its reform in 2008 and 2011[43]. Besides, this tax regime could lead to potential conflicts of dual residence, because since the non-dom normally keeps assets and income sources outside the United Kingdom, his emigration country could easily consider him as a resident. Even more, as the non-dom is taxed just on income from domestic sources, one could doubt about his consideration as resident for tax treaty purposes, because of the wording of the second sentence in Art. 4(1) of the OECD MC, according to which residence for tax treaties "does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein". And there is not a common solution for this question, because it will depend upon the view addopted by the envolved states in relation to the interpretation of what "liable to tax" means[44].

Anyways, in order to solve this question, the 2003 Revisions on the Commentaries to the OECD MC has added a Para 26.1 in Art. 4, trying to clarify that in cases of remittance base taxation taxpayers are not subject to potential double taxation to the extent that foreign income is not remitted to their state of residence. If in this case it is considered inappropriate to give them the benefit of the provisions of the tax treaty on such income, the Commentaries recommend that contracting states which agree to restrict the application of the provisions of the tax treaty to income that is effectively taxed in the hands of non-doms, should do so by adding a specific provision to their tax treaties.

3.2. Residence of companies and tax planning.

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[42] See the critics to this tax regime, and a description of its effects in attracting wealthy taxpayers in LANGER, Marshall J. "Harmful Tax Competition: Who are the Real Tax Havens?, in *Tax Notes International*, 18 December 2000, pp.6-7.

[43] In 2008 new legislation was introduced to provide that an individual who has been resident in the UK for seven or more years out of the last ten years would be obliged to pay an annual levy of £30.000 should they wish to continue to take advantage of taxation remittance basis. UK government in its 2011 Budget has reviewed the position and taxation of non-doms again. While recognising the valuable contribution that non-doms make to the economy, the government considered that the rules as they stood could discourage the investment of their foreign income and capital gains in the UK, and because of this reason there will no longer be a charge to tax when a non-dom individual remits foreign income or capital gains to make commercial investments in business in the UK.

[44] DIRKIS, Michael "The Expression…" cit., p. 149; for the UK solution to this question LEMOS, Marika "United Kingdom", in MAISTO, Guglielmo *Residence of Individuals…* cit., p. 617. Many of the UK tax treaties contain a provision to limit relief from source state taxation in such cases to the ammount that is taxed -after remittance- in the UK.

As regards legal entities, the first tax motivated decision to make -and thus the first one to thoroughly plan- is to choose the place of incorporation and legal seat, because these elements are decisive to determine tax residence in a given country. Obviously the decision about where to incorporate a company is influenced by other non-tax considerations, but the tax burden imposed plays an important role[45]. This is a logical consequence if we take into account tax competition between states and the heterogeneous, asymmetric domestic law criteria to define the corporate residence which lead to tax planning possibilities and tax arbitrage. Some of these possibilities, i.e. special purpose entities like conduit or base companies, holding companies, etc. have already been analysed and a proper response has been developed in both tax treaty and domestic tax laws[46]. Hence, we will not refer to this kind of tax planning issues but to the ones related to residence determination and criteria utilized to that effect.

The first and most evident alternative to reduce the tax burden is to incorporate companies or establish their legal seat on a tax haven. Nevertheless this option is far from being optimal, not only because the fight against tax havens is one of the biggest concerns in the international tax agenda[47] but also because operating in those territories raise many issues concerning a lack of an adequate legal framework and difficulties in raising capital. Thus, apart from the existence of tax measures that tackle the use of tax havens[48], issues concerning legal, financial and related matters severely limit their use. This occurs mostly because tax havens maneuvers indeed are

[45] As SHAVIRO, Daniel "The Rising Tax-Electivity…" cit., pp. 404 ss. pointed out, there are evidences in the field of start-ups, because tax haven incorporations arose to 10% of U.S. incorporations in the period 2005-2009 (and peaked at 30% in 2008).

[46] Probably for this reason, in OECD *Addressing Base Erosion and Profit Shifting*, OECD Publishing 2013, avalaible at http://dx.doi.org/10.1787/9789264192744-en (last review Septembre 5th 2013) there is only one reference to conduit structures that are set up to channel investments and intra-group Financing from one country to another, and a mención in p. 22, note 6 as an example of special purpose entities. See about this tax planning schemes and base companies OECD "R(6). Double taxation conventions and the use of conduit companies", in *Model Tax Convention on Income and on Capital 2010: Full Version*, OECD Publishing 2012, avalaible in http://dx.doi.org/10.1787/9789264175181-99-en; also DE BROE, Luc *International Tax Planning and Prevention of Abuse*, IBFD, Amsterdam 2008, pp. 5 ss. with further references.

[47] True, besides exchange of information developments with some tax havens we are quite skeptical about the genuine will to fight against tax havens, whose dissapearance has been announced too many times already; see HISHIKAWA, Akiko "The Death of Tax Havens?", in *Boston College International and Comparative Law Review* vol. 25, 2002, pp. 389 ss.

[48] Analyzed in ARNOLD, Brian J. and DIBOUT, Patrick "General Report", in IFA *Limits on the use of low-tax regimes by multinational businesses : current measures and emerging trenes*, Cahiers de Droit Fiscal International, vol. LXXXVIb, Kluwer, The Netherlands 2001.

not necessary to reduce the tax burden due to the existence of preferential regimes in many OECD countries and the possibility to reach them by sophisticated tax planning.

In this sense, the place of incorporation has lost relevance due to the decentralized structure that characterizes multinational enterprises, which are increasingly detaching the place where they are incorporated or their legal seat, and the places where they manage cash and group finances, intangible assets management, or where R&D activities are developed. As a matter of fact, in the past few years the most notorious cases discussed are related with the so-called "low taxed branches"[49], a concept contained in the OECD Report on Base Erosion and Profit Shifting.

In this kind of schemes a company can be incorporated and also have the legal seat in a high tax jurisdiction, achieving a low effective tax rate on the income received by providing loans, licences or services through a foreign branch that is subject to a low tax regime. This tax planning is specially convenient because one does not need even to access to a country that is formally considered a low tax jurisdiction since an accurate selection among preferential tax regimes implemented in OECD countries allows to obtain low taxation for interest, royalties etc. in the branch country. The only requirement to fulfill to get substantial tax savings is to locate the parent company in a country with an exemption regime for foreing branches income, either under domestic law or under the tax treaty network.

Back again on residence election matters, the use of different connecting factors in domestic tax laws may cause that two countries concurrently treat a company as resident for tax purposes. Far beyond difficulties on the application of the place of effective management criterion as tiebreaker rule in tax treaties scenarios - according to Art. 4(3) OECD MC- it must be stressed that these double residence schemes may sometimes be desired for tax planning purposes. At first glance, a company may want to avoid being considered resident in more than one country,

[49] OECD *Addressing Base Erosion and Profit Shifting*, OECD Publishing 2013, p. 40, avalaible at http://dx.doi.org/10.1787/9789264192744-en (last review Septembre 5th 2013). As an example of this practices one could take the structure implemented by Google providing his advertising services in the UK from Google Ireland, due to the lower corporate tax rate in the last country. See HOUSE OF COMMONS COMMITTEE OF PUBLIC ACCOUNTS, *Tax Avoidance–Google. Ninth Report of Session 2013–14*, avalaible in the House of Commons Internet website, at http://www.publications.parliament.uk/pa/cm201314/cmselect/cmpubacc/112/112.pdf (last review Septembre 5th 2013).

especially in the absence of a tax treaty. However, a company may want to be treated that way, for instance in order to benefit of dual consolidated loss transactions, which is a well-known example of international tax arbitrage[50].

In this kind of cases, a duplication of tax benefits is obtained through the intentional use of a company incorporated in the United States but managed and controlled in another country and therefore resident in both countries under their tax laws. Through borrowings or by other means, the dual resident company is placed in a loss position and the loss is claimed in each country through consolidation and group relief rules, as an offset to positive income in each country. As stated, there are no diffuse, indirect, or accidental elements in this planning[51], which could be developed just within few countries and therefore serves as an incentive to shift investment in that direction. This background is directly related with the residence rule for corporations, which varies widely and, in the case of the United States, is essentially elective[52].

Another reason for which a dual-resident company might be interesting for tax planning purposes relates to the application of tax treaties. As Art. 4(1) OECD MC defines the term "resident of a contracting State" by reference to domestic law, a company may want access to a (more beneficial) treaty network of another country through a dual residence company. It is obvious that changing the status of a company from single residence to dual residence creates access to the tax treaties of the secondary residence country and any other lower withholding tax rates provided in those treaties without necessarily increasing the overall tax burden[53]. In this regard, one could understand the OECD attempt to counter such practices by updating the

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[50] VAN DAELE, Jan "Tax Residence and the Mobility of Companies: Borderline Cases under Private International Law and Tax Law", in *European Taxation* vol. 51, 2011, p. 194. This kind of tax arbitrage achieves a tax "advantage" in one jurisdiction that is doubled in another jurisdiction; in Germany it is well know the case of the so called double dip leasing structure with Switzerland, due to the differences in the rules for to decide on when a taxpayer has the economic ownership of an asset. The Finance Bill 2013 has enacted new dual consolidation loss rules according to which a loss in a German Tax group (Organschaft) is to be disregarded -without carry fordward- for Germany tax purposes to the extent it is taken into account under a foreign tax regime applied to the controlling entity, the controlled entity or any other related party.

[51] ROSENBLOOM, H. David "International Tax Arbitrage..." cit., p. 148, making reference to the Dual Resident Companies in the United States.

[52] RING, Diane M. "One Nation Among Many: Policy implications of Cross Border Tax Arbitrage", in *Boston College Lae Review* vol. 44, 2002, pp. 116-117.

[53] VAN RAAD, Kees "Dual Residence", in *European Taxation*, vol. 8 , 1988, p. 245, apud. VAN DAELE, Jan "Tax Residence..." cit., p. 194.

OECD MC Commentary in 2008[54] in which a broad interpretation of the second sentence of Art. 4(1) of the OECD MC was introduced. Even more, one could admit that a dual residence conflict should be solved according to the tie breaker rule in Art. 4(3) of OECD MC. However, there are many arguments against the method contained in Para. 8.2 of the OECD Commentary on Art. 4 of the OECD Model, which is based on an incorrect interpretation of the second sentence of Art. 4(1) of the OECD Model, a provision that clearly was not intended to deal with such situations[55]. In this sense one has to bear in mind that in dealing with this problems John Avery Jones has stated that the solution "requires an addition to article 4 to be contained in all relevant treaties"[56]. This statement is quite significative if we take into account that -in a similar manner as Para. 8.2 of the Commentary to Art. 4(1)- he proposed that Art. 4 "would provide that a treaty resident of a state was a person who is liable to tax in that state under internal law by reason of the listed criteria but excluding a state that was the loser under a dual residence provision of any other treaty"[57]. Notwithstanding it should be obvious that, from a legal point of view, a solution that requires a modification of the tax treaty network cannot be obtained through a change in the OECD Model Commentaries.

As a consequence, even if sometimes dual residence companies could raise certain issues, an opportunity to tax planning may also be present due to the asymmetry on the determination of tax residence criteria by domestic law. Moreover, the use of domestic tax law different connecting factors generates loopholes that could be used to develop tax planning schemes such as double non-residence scenarios or, to put it in other words, a sort of worldwide non-residence or tax statelessness. Precisely, the U.S. Senate Memorandum in Apple Inc.[58] describes the

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[54] The modification of Para. 8.2 of the Commentary to Art. 4(1) OECD MC was introduced in order to state that " According to its wording and spirit the second sentence also excludes from the definition of a resident of a Contracting State (...) companies and other persons who are not subject to comprehensive liability to tax in a Contracting State because these persons, whilst being residents of that State under that State's tax law, are considered to be residents of another State pursuant to a treaty between these two States".

[55] VAN DAELE, Jan "Tax Residence..." cit., p. 195.

[56] AVERY JONES, John F. "Are Tax Treaties Necessary?", in *Tax Law Review*, vol. 53, 1999-2000, pp. 35-36.

[57] AVERY JONES, John F. "Are Tax Treaties..." cit. p. 35.

[58] PERMANENT SUBCOMMITTEE ON INVESTIGATIONS U.S. SENATE *Offshore Profit Shifting and the U.S. Tax Code - Part 2 (Apple Inc.)*, 2013 avalaible in the website, http://www.hsgac.senate.gov/subcommittees/investigations/hearings/offshore-profit-shifting-and-the-us-tax-code_-part-2 (last review Septembre 5th 2013).

unexpected consequences of the interplay between residence definitions in the domestic law of Ireland an the United States. While incorporated in Ireland, Apple Operations International (its primary offshore holding company) and Apple Sales International (its primary intellectual property rights recipient), are managed and controlled in the United States. With this structure, Apple takes advantage of the disparity between Irish and United States tax residency rules, because the companies are tax residents neither in Ireland -where residence is determined by the central management and control test- nor in the United States -where residence is determined by the incorporation under the laws of any State-, and therefore claims to have no tax residence in any jurisdiction. Quoting the Subcommittee statements, "Apple has been shifting its profits to its Irish subsidiary that has a tax residence nowhere, not to benefit from Ireland's minimal tax rate, but to take advantage of the disparity between Irish and U.S. tax residency rules and thereby avoid paying income taxes to any national government"[59].

Although available data are insufficient to properly study this case, it is indeed surprising that after an statement on the need of putting a stop to corporations that deny tax residence in any jurisdiction, Subcommittee recommendations do not refer to residence rules, i.e. the Memorandum states five recommendations related to transfer pricing rules, the "check-the-box" and "look-through" rules, CFC rules, the "same country exception" and the "manufacturing exception", but renounces to develop guidelines as regards the concept of residence, an aspect which turns to be essential after all.

Differences on domestic residence criteria also give rise to tax-planning strategies by means of tax residence changes. Nevertheless, apart from complex business restructuring arrangements subject to strict rules that guarantee their substance[60], hypothetical advantages of a change on residence are reduced due to the adoption of anti-avoidance rules and exit taxes by many countries. These rules and taxes are controversial as in a certain way may amount to a freedom of establishment

[59] PERMANENT SUBCOMMITTEE ON INVESTIGATIONS U.S. SENATE *Offshore Profit Shifting and the U.S. Tax Code...* cit., p. 28.
[60] SHAVIRO, Daniel "The Rising Tax-Electivity..." cit., p. 409.

restriction which, apart from its presence on EU law system, constitutes a mutual standard amongst most of the countries.

4. TACKLING TAX PLANNING THROUGH RESIDENCE.

As tax planning schemes are set up on the basis of the heterogeneous nature of various residence definitions, this will almost always imply an improper use of tax treaties and hence, one could opt to tackle this schemes through the traditional methods for curbing treaty-shopping practices, which existed since the 1977 OECD MC. Even if successive changes on OECD Commentaries have included few measures in order to allow treaty benefits only to entities having a sufficient nexus with the residence country, most of the OECD anti treaty-shopping provisions tend to be broad and vague, likely to generate interpretational difficulties when applied in practice[61].

The analysis of these measures is out of the scope of this paper, in which we will focus our attention on two specific types of provisions, directly related to changes in residence: extended tax liabilities or trailing taxes as protective measure, and exit taxes. On the one hand, unlimited extended tax liability, which is based on the assumption that the emigrated taxpayer continues to qualify as a deemed resident of the country of former residence despite the fact that he has established his residence for tax purposes in another country. On the other hand, exit taxes that treat the act of emigration as a taxable event, resulting in the deemed alienation of all (or some) items of property, affecting the latent income tax liability that exists at the time of emigration[62]. In any case, both kind of measures, when applied by emigration countries would conflict with tax treaties and therefore are in some way controversial.

4.1. The extension of residence.

Obviously, the emigration country can always counteract alleged transfers of residence that actually did not happen by considering them as a mere sham, according to their domestic rules or doctrines. In this case it is out of doubt that when applying

[61] Probably, except the LOB provisions, as pointed out AVI YONAH, Reuven S. and HJI PANAYI, Christiana "Rethinking Treaty Shopping: Lessons for the European Union", in AAVV *Tax Treaties: Buildig Bridges between Law and Economics*, IBFD, Amsterdam 2010, p. 33.

[62] For a broader information on the topics see DE BROE, Luc "General Report" cit., pp. 29 ss. and Branch Reports in IFA *The Tax Treatment of the Transfer...* cit., pp. 97 ss.

sham provisions or jurisprudence the tax authorities are determining which facts give rise to a tax liability, and acting according with tax treaties[63]. Indeed there is a growing attention by tax authorities in this field, especially when the individual moves to a tax haven or a neighbour country known for permitting the taxpayer to realize in a tax free manner income or gains which would not have been exempt absent the transfer of residence.

Even if we admit an actual transfer of residence, emigration countries may apply defensive measures in order to limit tax-motivated behaviors. In this sense, the Scandinavian countries have enacted legislation in order to deny non-residence status to temporary non-residents (short-term leavers) in the framework of their unlimited extended tax liabilities. In this sense, the rules basically provide for a reversal on the burden of proof, i.e. it is the taxpayer instead of the tax authorities who has to give evidence that he has effectively cut off all substantial ties with the country of former residence. Even if one could understand the policy behind this kind of rules, as far as the limited tax liability should concern only persons who have actually moved away from the emigration country, its content is open to criticism.

First, it is far from clear which pieces of evidence should or must the taxpayer provide in order to prove that he has actually moved to another country, and specially which weight a certificate of residence will have as an evidence. Proportionality principle should play its role in the task of looking for proper solutions and their strict adherence to the law, specially regarding the certificate of residence dissimilar significance amongst different jurisdictions. This should also be a concern from the tax treaties perspective, because if tax authorities impose a higher burden of proof on the taxpayer in trying to determine his residence than the one required in a pure domestic case, an issue arises on whether this is compatible with the objectives and purpose of the tax treaty[64].

Second, this kind of rules seems to be barely compatible with tax treaties that are normally based on residence and do not give any special taxing rights to the state

[63] As in all pure sham cases; see ZORNOZA, Juan J. and BÁEZ, Andrés "The 2003 Revisions on the Commentary to the OECD Model on Tax Treaties and GAARS: a Mistaken Starting Point", in AAVV "*Tax Treaties…*" cit., pp. 135 ss.

[64] LANG, Michael "General Report", in IFA *Double non-taxation*, Cahiers de Droit Fiscal International, vol. 89a, Kluwer, The Netherlands 2004, p. 92.

on which the taxpayer is a national. In this sense, the application of these rules by the emigration country will very likely result in a conflict of residence with the immigration country, which will generally be solved in favor of the latter under the tax treaty tiebreaker rules. Besides, an unlimited extended tax liability under domestic law cannot effectively be imposed on emigrants under tax treaties if it does not specifically allow the emigration country to do so. Indeed, unlimited extended tax liabilities are only effective -under tax treaty law- provided that the emigration country has preserved its rights to apply such extended tax liability in the relevant tax treaty. Hence, countries applying this kind of domestic rules have promoted tax treaties that allow the emigration state to tax the former resident according to it[65].

Third, even if the tax treaty permits a residence extension, this kind of measure gives rise to international double taxation since both the emigration and the immigration country will consider the individual as resident and subject him to tax on his worldwide income. Probably both states will give relief (by means of credit or exemption) for taxes levied by the other country on income arising in the other country that has been subject to tax there[66]. But this fact is not clear enough, because the immigration country may give rise to a double residence conflict and once resolved in its favor, give relief just on taxes levied in respect to income sourced in the emigration state. Besides, as it is far from clear whether the emigration country will give relief for the tax imposed on that third-country income by the immigration country, one has to conclude that it is necessary to reflect on the meaning and justification of these rules.

In any case, it has to be remarked that also in this field, differences between rules enacted by countries in their domestic laws differ in certain substantial aspects: i) there are rules which apply just if the immigration country is a tax haven but other immigration country relevant factors are irrelevant ; ii) in some cases taxpayer proof of an actual change of residence is permitted, while in other cases a deemed residence rule establishes a *iuris et de iure* presumption of residence; and iii) the period for extended tax liability is generally limited to 3, 5 or 10 years, but there are some

[65] See DE BROE, Luc "general Report" cit., pp. 45 and 68; HELMINEN, Marjaana "Finland", in IFA *The Tax Treatment of the Transfer...* cit., pp. 238-239
[66] DE BROE, Luc "General Report" cit., p. 61.

scenarios in which the extended residence seems to be forever after, and this may be considered a plain abuse.

At last, the measures at stake pose evident management issues, because if the emigrant taxpayer does not have any assets on the emigration country, it will be difficult to levy the tax, except through cooperation mechanisms between tax administrations. Thus, it is notable that when analyzing individual transfers of residence treatment no specific recovery methods for taxes owed by former residents where reported. This is remarkable because the emigration country is often left with little or no assets against which tax claims could be recovered, and cannot rely on an expanded treaty network for the cross-border recovery of taxes, due to the lack of cooperation in this field outside the European Union[67].

4.2. Exit taxes.

The second kind of measures adopted by emigration countries to counteract the transfer of residence for tax purposes are the so-called "exit taxes", which treat the act of emigration as a taxable event resulting in the deemed alienation of the emigrant assets, affecting the latent income tax liability that exists at the time of emigration. As in this area a large number of figures exist with many different configurations, to develop a proper analysis in this regard seems to be impossible[68], so general considerations should be made regarding a kind of measures that affects both individuals and companies.

Among them, the first that one has to consider are those that aim at accelerating the payment of tax liabilities that the taxpayer incurred in the country from which he moves; even if these are not properly exit taxes. In this sense, in order to ensure that an emigrant has no outstanding liabilities, several countries have introduced a “pay as you go” system and, either *ex officio* or at the discretion of the tax authorities requires to the taxpayers who gives up his residence in the country to

[67] DE BROE, Luc "General Report" cit., p. 32. There has been an important progress in this field, because since January 1st 2012 mutual recovery assistance is governed by the Council Directive 2010/24/EU which extends the scope of the recovery assistance to all taxes and duties levied by EU Member States. It also introduces a European instrument permitting enforcement in another Member State as the sole basis for recovery measures taken in the requested Member State.

[68] See DE BROE, Luc "General Report" cit., pp. 32 ss. and the Branch Reports in IFA *The Tax Treatment of the Transfer...* cit., pp. 97 ss.

comply with certain administrative formalities in view of imposing an advance assessment and to pay all taxes due for the year of departure[69].

Both general exit taxes and limited exit taxes on certain capital gains -normally those derived from shares and securities- *raison d'être* is related with the interplay between the non-residents taxation in the emigration country and tax treaties[70]. A general exit tax focuses on taxation of income that could not be taxed after the change of residence because this practice may be forbidden by non-resident tax regime or double tax treaties. However, if the exit tax just affects the former resident's non-realized gains that could not be taxed after its change of residence because of the applicable double tax treaty, this measure may certainly contravene the treaty in force. Hence, it seems senseless to apply a general exit tax for latent capital gains that corresponds to assets which remain at the emigration country where a tax could be levied in accordance with the non residents domestic tax regime and tax treaties in force. This measure may seem disproportionate, as the emigration state power to tax and the collection of taxes are adequately guaranteed.

Taking this justification into account, the balanced allocation of taxing rights between jurisdictions seems to be the only possible ground for levying exit taxes, which implies they must be aimed at taxing gains that accrued while the person was resident in the country of emigration and could not be taxed after the transfer of residence[71]. This raises some requirements for the correct articulation of the exit taxes, in the sense that it should be limited to the gains that the emigration country could not tax after the transfer of residence because of the tax treaties in force. This is a proper way to protect the territoriality principle in the international field and at the same time force states to take responsibility on the task of designing an efficient tax on non-residents. Hence, no immediate taxation of unrealized gains should be allowed if, in the domestic scenario, the country of emigration does not tax the gains; not just for the sake of consistency -this assessment could not be justified by the need for a

[69] DE BROE, Luc "General Report" cit., p. 32.

[70] Even if limited exit taxes seems to be related with the fact that some countris have relinquished their taxing rights on capital gains on shareholdings to the country of residence of the shareholder either under domestic law or under their domestic or trety provisions; see DE BROE, Luc "General Report" cit., p. 37.

[71] VAN DAELE, Jan "Tax Residence..." cit., pp. 274-275, on the grounds of the Case Law of the European Court of Justice in Case C-9/02, *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie*, and Case C-470/04, *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo.*

proper allocation of taxing rights- but also to respect non-discrimination rules. Besides, as the exit tax applies to unrealized gains it is doubtful whether, or not, the country of emigration should take into account any decreases in the value of the assets after the person ceases to be a resident. Even if the European Court of Justice has suggested this position in *N* case one cannot agree with this view because it is not coherent with the allocation of the power to tax since the country of emigration will not be able to tax increases in value after the transfer of residence[72]. Lastly, to adequately levy tax on latent capital gains, valuation rules are critical because due to the non existence of a real transaction, discussions regarding the tax base determination will always exist.

In the exit taxes the accrued capital gains are taxed in the residence state of the owners, just before they ceased to be resident for tax purposes, even though no actual alienation has occurred, on the grounds of a legislative fiction. Therefore, these taxes are levied on non-realized capital gains, which may be problematic from an ability to pay principle point of view and can give rise to liquidity issues[73]. Because it is far from clear if the need for a balance allocation of taxing rights can justify the exit taxes from an internal constitutional point of view in the countries in which ability to pay is a constitutional principle for the tax system. Even if the illiquidity argument is not convincing, because the tax authorities can provide for financial facilities -i.e. tax deferrals or payments plans- there are serious concerns in relationship with the valuation problem[74]. Because it the exit tax is not perfectly designed, could result in the assessment of a capital gain that could never exist.

The most controversial aspect on exit taxes is however related with its compatibility with tax treaties and the double taxation that may arise from applying it. In this respect, neither the OECD MC, nor the UN MC contain a specific provision on exit or expatriation taxes, whether on individuals or companies; even if in recent years, states have begun amending and redrafting their bilateral treaty provisions in an attempt to eliminate double taxation in these cases. It is truth that international tax law does not prohibit countries from imposing exit taxes on their residents, and for

[72] VAN DAELE, Jan "Tax Residence..." cit., p. 275.

[73] See with further references BÁEZ MORENO, Andrés "El “valor razonable” y la imposición societaria. (Un apunte sobre la idoneidad fiscal de las normas internacionales de información financiera)", in *Nueva Fiscalidad* nº 10, 2006, pp. 115 ss.

[74] Which is the most important concern in relationship with ability to pay; see BÁEZ MORENO, Andrés "El valor razonable..." cit., pp. 133 ss. with further references.

this reason emigration countries believe that the introduction of exit taxes does not constitute a treaty override. The main arguments in this sense are the following: i) as exit taxes are assessed just before the tax liability based on residence ceases, one can say that at the time of imposition of the exit tax the taxpayer is a resident of the country imposing the tax; ii) as tax treaties allocate taxing rights in the case of alienation of assets, conflict issues do not arise because exit taxes are not imposed on the occasion of the alienation; iii) no double taxation occurs -at least in a proper sense- since double taxation implies that two different countries tax the same income at the same time, which is not the case in exit taxes that are levied only in the emigration country.

Notwithstanding, these arguments are not persuasive enough, because exit taxes are contrary to the tax treaties allocation of taxing rights standards. In this sense, both the OECD MC and the UN MC allocate taxing rights on capital gains on assets (other than real property, permanent establishment assets and ships and aircraft) in a clear way. The exclusive right to tax gains on items of personal property is granted to the state of residence of the alienator, except, under the UN model, where the right to tax gains on substantial shareholdings is allocated to the country where the company is established. One has to assume that countries that use such models without any reservation do accept that taxpayers could one day transfer their residence and thus that emigration countries could lose their taxing rights by virtue of such provisions[75].

It is truth that Para. 7 of the Commentaries on Art. 13 OECD MC states that "(T)here are, ..., tax laws under which capital appreciation and revaluation of business assets are taxed even if there is no alienation". Moreover, as the term "alienation" has to be interpreted broadly, in order to cover all the transactions or events generating a gain in the domestic law, one could think that the cases of deemed alienation fall under the scope of Art. 13[76]. However, once properly contextualized, this statement does not lead to support the view that countries are entitled to tax unrealized gains that accrued prior to emigration. First, because if we take into account OECD MC prior versions it is not easy to affirm that a transfer of residence is an "alienation" for Art. 13

[75] In this sense DE BROE, Luc "General Report" cit., pp. 65 ss.
[76] SIMONTACCHI, Stefano *Taxation of Capital Gains under the OECD Model Convention: With Special* , Kluwer, The Netherlands 2007, p. 185.

OECD MC purposes[77]. Second, because Para 8, 9 and 10 of the Commentaries, when dealing with the taxation of the capital appreciation of an asset that has not been alienated, do mention only the revaluation of assets in the books and the transfer of an asset from a permanent establishment situated in the territory of one state to a permanent establishment or the head office of the same enterprise situated in another state. Hence, if just these two cases are assimilated to an alienation of property, is becomes hard to accept that other options on establishing an exit tax on deemed alienation may fit on Art. 13 OECD MC.

In any case, it is out of doubt that exit taxes create double taxation, and it may be questioned whether the notion of double taxation as defined above is not too narrow: what matters is not that two taxes are imposed in the same year, but that such taxes relate to income that accrued during identical periods[78]. From this point of view, it is clear enough that an expatriation event that results in a deemed alienation of property also has the potential for double taxation or even triple, because on top to the exit tax in the expatriation country one should consider the tax on the capital gains levied by the immigration country -as residence state- and eventually the tax levied by the source country when the assets where located in a third country and the relevant tax treaty allows it[79]. Hence, the current enactment of new domestic exit taxes without taking any measure to avoid international double taxation and leaving it up to the immigration country to do so either unilaterally or at best via a mutual agreement procedure under a DTC seems not to be acceptable[80].

Finally, even if it has been considered that one of the goals of an exit tax is the prevention of tax avoidance, the anti-avoidance intention does not justify in itself the imposition of exit taxes. It is truth that Para. 9 of the Commentaries to Art. 1 OECD MC considers that emigration to realize capital gains in a tax free manner in another country of residence constitutes a treaty abuse. But that even if one could accept that the Commentaries are a sufficient ground for the enforcement of domestic anti-abuse

[77] In this sense DAURER, Veronika "Austria", in MAISTO, Guglielmo (ed.) *Residence of Individuals...* cit., p. 275 states that the concept of capital gains is based on the change of ownership. Therefore exit taxes can not be covered by Art. 13 OECD MC.
[78] DE BROE, Luc. "General Report" cit., p. 67.
[79] HALABI, Oz "Expatriation Tax..." cit., p. 380 provides a good example.
[80] DE BROE, Luc. "General Report" cit., p. 68 and HALABI, Oz "Expatriation Tax..." cit., p. 380.

measures in a treaty context[81], Para. 10 of the Commentaries suggests that the contracting states should agree that the tax treaty in question does not affect the applicability of domestic anti-abuse provisions. Notwithstanding, exit taxes are introduced unilaterally without due regard to the tax regime applicable abroad and very few treaties explicitly authorize their assessment on a bilateral basis, thus are against the intention expressed in Para 10 of the Commentaries to Art. 1.

As the number of countries introducing exit taxes is likely to increase, it seems necessary to reconsider exit taxes in order to align them with tax treaties and the aim of preventing double taxation. In this sense, the determination of a common value of the relevant property items upon transfer of residence should play a critical role. Therefore, this system only success if it is enacted on a bilateral or multilateral basis. Also, it is highly recommended to include a procedure for the determination of such a common value between the competent authorities of the two countries involved and the taxpayer, eventually with an appeal or arbitration procedure[82]. Moreover, if exit taxes *raison d' être* lies on a balanced allocation of taxing powers one might ask for proper mechanisms to achieve this purpose. In principle, exchange of information and administrative assistance procedures should be enough to guarantee the chance of the emigration country to require assessment of the capital gain generated during the period of residence, avoiding the undesirable effects of exit taxes.

5. CONCLUSIONS.

As stated, the interplay between diverse criteria employed by domestic laws to define residence may generate arbitrage and tax planning possibilities encouraged by countries' tax competition practices. Attempts to limit those possibilities have forced states to adopt certain measures that frequently give rise to tax treaties compatibility issues or tax treaty override behaviours.

The analysis developed allowed us to check how the awareness of these problems has not prompted a reflection on the concept of residence used in tax treaties, which appears to be content empty and, therefore, is only anchored by the

[81] Which is not the case for the reasons explained in ZORNOZA, Juan J. and BÁEZ, Andrés "The 2003 Revisions on the Commentary..." cit., pp. 138 ss.
[82] As suggest DE BROE, Luc. "General Report" cit., p. 67.

effect of producing an unlimited liability to tax. However, it is clear that reconsideration on the residence definition and the suitability of maintaining criteria no longer adequate to achieve proper results should be developed. We do not disbelieve that residence should continue to serve as a connecting factor, but current criteria for its determination do not seem the most appropriate in a world in which mobility of persons and production factors is higher than ever.

Significant changes in a highly globalized economy, in which interconnected markets and agents smoothly interact, have not been reflected in tax treaty agreements or, at least, not in the structure and contents of the OECD MC and UN MC. The frequency with which changes occur in the Commentaries to those MC contrasts with the unvarying nature of their texts, which reflect outdated income tax categories - typical of ancient impersonal taxes- that do not correspond to the current reality. As a matter of fact, the MC as we know them are by full unsuitable for the treatment of international economic transactions, as shown by the difficulties on the treatment of hybrid financial products, hybrid entities, etc.

Despite the fact that I am not optimistic about the possibilities of success of the proposals for a global cooperation and coordination on tax matters[83], it is true that it an in depth reconsideration of the MC seems necessary. A reconsideration that will probably require a harmonization of tax treaties institutions and concepts, and that seems particularly necessary as regards the residence determination, as the main pillar on the definition of tax treaties subjective scope. This kind of harmonization may limit arbitrage possibilities in a much more effective way than any of the measures already analyzed, whose suitability in the international tax law arena is more than questionable.

[83] As, for example, the one made by BRAUNER, Yariv "An International Tax Regime in Crystallization", in *Tax Law Review* vol. 56, 2003, pp. 263-264 and 294 ss.