

Part I

Section 894.—Income Affected By Treaty

26 CFR 1.894-1: Income affected by treaty

Rev. Rul. 2004-76

ISSUE

If Corporation A, a resident of both Country X and Country Y under the laws of each country, is treated as a resident of Country Y and not of Country X for purposes of the X-Y Convention and, as a result, is not liable to tax in Country X by reason of its residence, is it entitled to claim the benefits of the U.S.-X Convention as a resident of Country X or of the U.S.-Y Convention as a resident of Country Y?

FACTS

Situation 1

Corporation A is incorporated under the laws of Country X. Its place of effective management is situated in Country Y. Corporation A does not have a fixed place of business in Country X. Under the laws of Country X, prior to application of any income tax convention, Corporation A is liable to tax as a resident. Under the laws of Country Y, prior to application of any income tax convention, Corporation A is liable to tax as a resident. Corporation A receives U.S.-source income during the taxable year, with respect to which it seeks benefits under either the U.S. income tax convention with Country X (U.S.-X Convention) or the U.S. income tax convention with Country Y (U.S.-Y Convention).

The relevant articles of the U.S.-X Convention and the U.S.-Y Convention each provide:

Except as provided in this paragraph, for the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature.

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The term "resident of a Contracting State" does not include any person who is liable to tax in that State in respect only of income from sources in that State.

There is in force an income tax convention between Country X and Country Y (the X-Y Convention) that contains the following article with respect to residence:

For purposes of the Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

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Where by reason of the above paragraph, a person other than an individual is a resident of both Contracting States, the person shall be deemed to be a resident only of the State in which its place of effective management is situated.

Situation 2

The facts are the same as in *Situation 1* except that Corporation A has a fixed place of business in Country X, to which the income is attributable.

LAW AND ANALYSIS

In *Situation 1*, before application of the X-Y Convention, Corporation A would be a resident of both Country X and Country Y under the domestic laws of each of Country X and Country Y. After the application of the relevant article of the X-Y Convention, Corporation A is treated as a resident of Country Y and not a resident of Country X because its place of effective management is situated in Country Y.

Accordingly, Corporation A continues to be liable to tax in Country Y by reason of residence. Therefore, under the relevant article of the U.S.-Y Convention, Corporation A is a resident of Country Y. Corporation A will be entitled to claim benefits under the U.S.-Y Convention as a resident of Country Y with respect to the U.S.-source income if it satisfies the requirements of the applicable limitation on benefits article, if any, and other applicable requirements in order to receive benefits under the U.S.-Y Convention.

Because Corporation A is treated as a resident of Country Y for purposes of the X-Y Convention, Corporation A is not subject to comprehensive taxation in Country X as it would be if it were liable to tax by reason of residence. Therefore, Corporation A is not a resident of Country X under the relevant article of the U.S.-X Convention and is not entitled to claim benefits under the U.S.-X Convention as a resident of Country X.

In *Situation 2*, after the application of the X-Y Convention, Corporation A continues to be liable to tax in Country Y by reason of residence. Therefore, under the relevant article of the U.S.-Y Convention, Corporation A is a resident of Country Y. Corporation A will be entitled to claim benefits under the U.S.-Y Convention as a

resident of Country Y with respect to the U.S.-source income if it satisfies the requirements of the applicable limitation on benefits article, if any, and other applicable requirements in order to receive benefits under the U.S.-Y Convention.

Because Corporation A is treated as a resident of Country Y for purposes of the X-Y Convention, Corporation A's fixed place of business in Country X is treated as a permanent establishment within the meaning of the X-Y Convention. Thus, Corporation A is liable to tax in Country X in respect of profits attributable to its permanent establishment, but is not subject to comprehensive taxation in Country X as it would be if it were liable to tax by reason of residence. Therefore, Corporation A is not a resident of Country X under the relevant article of the U.S.-X Convention and is not entitled to claim benefits under the U.S.-X Convention as a resident of Country X.

Rev. Rul. 73-354, 1973-2 C.B. 435, provided that a bank incorporated in Switzerland, managed and controlled in the United Kingdom, and engaged in the conduct of a business in both Switzerland and the United Kingdom, could choose to apply the provisions of either the United States-Swiss Confederation Income Tax Convention then in force or the United States-United Kingdom Income Tax Convention then in force to interest arising in the United States. Under those conventions, which are no longer in force, the determination of whether a corporation was a resident did not depend on whether the corporation was liable to tax in that country.

HOLDING

If Corporation A is treated as a resident of Country Y and not of Country X for purposes of the X-Y Convention and, as a result, is not liable to tax in Country X by reason of its residence, it is not entitled to claim benefits under the U.S.-X Convention, because it is not a resident of Country X under the relevant article of the U.S.-X Convention. However, Corporation A is entitled to claim benefits under the U.S.-Y Convention as a resident of Country Y, if it satisfies the requirements of the applicable limitation on benefits article, if any, and other applicable requirements in order to receive benefits under the U.S.-Y Convention.

This holding is applicable in interpreting income tax treaties that contain provisions that are the same as or similar to the relevant articles of the U.S.-X Convention, the U.S.-Y Convention, and the X-Y Convention.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 73-354, 1973-2 C.B. 435, is obsolete.

DRAFTING INFORMATION

The principal author of this revenue ruling is Michelle S. Lyon of the Office of Associate Chief Counsel (International). For further information regarding this revenue ruling, contact Ms. Lyon at (202) 622-3880 (not a toll-free call).