Taxation of Trusts, Foundations and Similar Arrangements in a Global Setting

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income or gain for tax purposes.[2] The focus is on express trusts only, not implied or constructive trusts.

The discussion only covers the taxation of trust income and gains. There is no discussion of estate, gift and inheritance taxes.[3] All references to tax treaties are (unless otherwise stated) to the 2017 version of the OECD Model Double Taxation Convention on Income and Capital Gains (hereinafter 'the OECD Model').

1.1 Different Levels of Trust Taxation

There is considerable scope for double taxation of trust income and gains, with limited scope for relieving that double taxation. One major reason for this is competing jurisdictional claims on the same income and gains. These claims are:

- *taxation of trust income and gains at source* (e.g., source taxation of rental income or real estate gains realised by the trustees).
- *taxation of income and gains at trust level*, whether or not income and gains are distributed by the trust. This will arise if the trustee(s) are regarded as resident in a jurisdiction which taxes trustee(s) resident in it. Some jurisdictions do not tax locally resident trusts, e.g., those tax havens (such as the Channel Islands) where it is possible to form trusts.
- *one or more beneficiaries may be taxable on the income and gains of the trust, even if that income and gain has not been distributed*. This is most likely to arise if the beneficiary has a fully vested interest in the income or gain of the trust.[4]
- *one or more beneficiaries may be taxable on the income and gains of the trust, but only when distributed*. This is most likely where the trust is a discretionary trust, whose beneficiaries have no fixed entitlement to trust income and gain. Rather the trustee(s) must consider whether or not to distribute and if so, to which beneficiary. However, no beneficiary can insist on receiving a particular amount. If the terms of the trust entitle the trustees to accumulate trust income rather than distribute it, there may be no distribution at all for an extended period.[5]

2. This is of course an oversimplification. Not all jurisdictions recognise the existence of trusts and, as discussed elsewhere in this book, jurisdictions may disagree on how to classify items of income and gain for tax purposes.
3. These are in practice very important when taxing trusts: *see* 'Classifying Entities', *supra* n. 1, at 124-134. The new (July 2024) UK Government has made significant changes to the UK inheritance tax treatment of trusts, which can increase the inheritance tax burden on some trusts with non-UK-situated assets.
4. Much depends on how the jurisdiction where the beneficiary is resident analyses its interest in the trust for tax purposes. E.g., in the UK, a vested beneficial interest in the income of a trust governed by English law (or the law of some other jurisdictions) leads to a UK-resident holder of that interest being taxed on a 'transparent' basis, under the so-called rule in *Baker v. Archer-Shee*. In short, as if it were entitled to a share of the underlying trust income (whether or not distributed), after deducting certain trust expenses and taxes: *see* 'Classifying Entities', *supra* n. 1, at 79-94.
5. If a beneficiary is taxable in respect of a trust distribution, how it is taxed will depend on how its jurisdiction of residence analyses a trust distribution. Will it treat that distribution as a source of income or gain which is distinct from the underlying income and gain of the trust? Or will it treat the beneficiary as receiving a pro rata share of that underlying income and gain i.e., a 'transparent' approach? The analysis adopted may materially affect the beneficiary's tax treatment. Indeed the UK uses both approaches in different situations: *see* 'Classifying Entities', *supra* n. 1, at 96-102.

- *income or capital gains of the trust may be taxable by attribution to the 'grantor'/'settlor' of the trust*. The 'grantor' (in US parlance) or 'settlor' (in English law) is the person(s) who directly or indirectly formed and funded the trust and who is/are presumed to have ongoing de facto influence over it (e.g., via a letter of wishes to the trustees). Hence it is appropriate to attribute trust income and gains to that person, whether or not it retains a direct economic interest in the trust assets.[6]

These different concurrent tax claims on the same income and gains of a trust explain in part why many trusts are set up in tax havens. This should at least mitigate the tax charge at trust level. As will be discussed below, significant double taxation problems remain.

2 CAN A TRUST OR FOUNDATION BE A TREATY-RESIDENT?

As already discussed, trusts are typically (although not always) analysed as a relationship rather than a separate legal person. By contrast, a foundation is usually analysed under its governing law as a separate legal person, although one which has no members and where the 'founder' (the settlor-equivalent) is expected to have considerable ongoing control over the foundation.[7]

Even if a trust is not a legal person in its own right, it can be a 'person' for the purposes of Article 3(1)(a) of the OECD Model, on the basis that it is either a 'person' (if there is a sole trustee) or a 'body of persons' (if more than one trustee). The Commentary to Article 3 of the OECD Model supports this interpretation, which properly separates the fiduciary and non-fiduciary activities of the person(s) who is or are trustees. The definition of 'person' in treaties entered into by the US and Canada normally includes a 'trust' explicitly in that definition.[8]

For that 'person' to be a 'resident' of a contracting state under Article 4(1) of the OECD Model, it must be 'liable to tax' in that state by reason of 'domicile, residence, place of management or any other criterion of a similar nature'.[9]

6. Settlor/grantor taxation by attribution is a complex topic. Different jurisdictions take different approaches about the ongoing interest or influence in relation to a trust which a settlor/grantor must have, in order to be subject to such taxation. While UK tax law will routinely attribute 'settlement' income and (in the case of non-UK trusts or 'settlements') capital gains to a UK-resident settlor, this does not normally entail disregarding the trust altogether for tax purposes. In particular, with limited exceptions (notably in relation to inheritance tax), the settlor is not treated as continuing to own the trust assets. By contrast, the US rules for taxing 'grantors' can apply in a more radical way, so that the grantor is treated as continuing to own the trust assets for various tax purposes: *see* 'Classifying Entities', *supra* n. 1, at p. 227. The Netherlands will even impose an ongoing Dutch tax liability on the Dutch heirs and successors of the settlor, in respect of the trust income and gains.
7. For a more in-depth discussion of the commentary and case law on the nature of a foundation for tax purposes, *see* 'Classifying Entities', *supra* n. 1, at pp. 67-69 and in particular, footnote 181.
8. For example, Art. 3(1)(a) of the UK-US tax treaty of 2001 (SI 2002/2848).
9. For a recent UK decision on the meaning of the equivalent words in the UK-US treaty, *see HMRC v. GE Financial Investments* [2024] EWCA Civ 797. This involved a UK company, not a trust. The UK Court of Appeal considered Art. 4(1) of the OECD Model. It concluded that a connecting factor could not give rise to residence within Art. 4(1), unless there was a 'local connection' via one of

Sometimes, a trust can be treated as a 'company', and hence be regarded as a 'person' for treaty purposes because it is an 'entity *treated as a body corporate for tax purposes*' (emphasis added): *see* Article 3(1)(b) OECD Model. Good examples of this are UK 'authorised unit trusts' and non-exempt 'unauthorised unit trusts'. Both these types of UK collective investment vehicles are deemed to be UK-resident companies and indeed 'bodies corporate'. Interests in them are also treated, for tax purposes, as 'shares'.[10] Looking further afield, Italian tax law treats a trust 'without identified beneficiaries' (e.g., a 'discretionary trust') as a company for Italian tax purposes.[11]

There are indications from judicial decisions to date that a foundation should be regarded as a 'company', and hence a 'person' for treaty purposes.[12] Those decisions suggest that a foundation should be regarded as a 'company' even though it does not have members in the way that most companies do.

Similar comments can be made about the Liechtenstein Anstalt. Under Liechtenstein law, an Anstalt can be set up with 'founder's rights' (so that it more closely resembles a company) or without such rights (so that it more closely resembles a foundation).[13] Either way, it does not look very obviously like a trust.[14]

Returning to the earlier point about treaty residence, a trustee(s) should only be regarded as 'resident' in a contracting state if its tax liability in respect of income and gain is *not* simply 'representative'. In other words, its liability must be determined without reference to the tax identity and characteristics of the beneficiaries. This may not be the case where, in particular, a beneficiary has a vested current entitlement to trust income, e.g., under a 'bare' trust, where one or more beneficiaries have fully vested current interests in both income and capital, or under trusts where there is a life interest in trust income. In such cases, when deciding if there is a 'resident of a

the listed residence criteria in Art. 4(1) (e.g., domicile, place of management or incorporation) or via another criterion of a 'similar nature' to those listed. Furthermore, any such criterion must give rise to 'worldwide', rather than purely source-based taxation. Deemed US tax residence of a UK company because of the US's anti-stapling rule did not have the requisite 'local connection' with the US. Therefore the company was not US-resident for treaty purposes. The case was heard without any discussion of the history of Art. 4(1) of the OECD Model, which tends to favour the (losing) argument of the taxpayer. The author thanks Dr John Avery Jones CBE for pointing this out.

10. Section 617 Corporation Tax Act 2010 and Regulation 28 Unauthorised Unit Trusts (Tax) Regulation 2013 (SI 2013/2189, as amended). 'Company' is in fact a broader concept than 'body corporate' for UK tax purposes. Deeming interests in such vehicles to be shares may also affect how other Articles of the OECD Model apply to those interests, e.g., the Dividends, Interest and Capital Gains Articles (i.e., Arts 10-12).
11. This may make it eligible also for the benefits of the EU Parent-Subsidiary Directive 2011/96/EU (as amended) if (*see* Annex I Part A of that Directive), such a trust resident in Italy is a private entity 'whose activity is wholly or principally commercial'.
12. *See* the Canadian decision in *H.M. The Queen v. Peter Sommerer* 2012 FCA 207, discussed in detail in 'Classifying Entities', *supra* n. 1, at pp. 67-68.
13. The author wishes to thank Dr Marco Felder, of Felder, Sprenger and Partner AG, Vaduz, for providing this information.
14. The UK tax authorities have been known to argue that an Anstalt is a form of trust, although this does not seem to be their current position. *See also* 'Classifying Entities', *supra* n. 1, at 69, especially fn 183.

contracting state', one should focus instead on the beneficiary with the vested entitlement rather than the trustee(s).[15]

Furthermore, suppose that a trustee is resident in one jurisdiction ('A') while a beneficiary with a vested interest in trust income is resident in another jurisdiction ('B'). If the tax charge on the trustee in respect of trust income and gains is purely representative, one would not expect it to extend to income and gains from sources outside state A. Otherwise A would be taxing a non-resident of A in respect of non-A-sourced income and gains. If the tax charge on the trustee in A does not extend to non-A-sourced income and gains, the closing words of Article 4(1) of the OECD Model make clear that the trustee is not a resident of A for treaty purposes.

If trustees are a 'person' or 'body of persons' within Article 3(1)(a), then in the relatively rare cases where a trust is resident, for Article 4(1) purposes, in both contracting states, the relevant tie-breaker provision should be Article 4(3) of the OECD Model. This only applies to a person who is treaty-resident but not an 'individual'. Natural persons can of course be trustees either by themselves or together, for example, with a corporate trustee. However, even if a natural person is a trustee, it makes more sense to treat such persons, in their trustee capacity, as not being an 'individual' for Article 4 purposes. Otherwise, the relevant tie-breaker rule would be Article 4(2) which tends to focus much more on the personal circumstances of the individual concerned, rather than (more relevantly) on where the activities of the trust are conducted. If a natural person and a company act as trustees together, then if those trustees are a single 'body of persons', Article 4(3) requires one to consider factors such as that single entity's 'place of effective management'. This seems more relevant than focusing on the specific circumstances of each trustee in isolation, especially if the trustees are not resident in the same jurisdiction. So overall the Article 4(3) tie-breaker seems the more appropriate tool to apply to dual-resident trusts. The drawback is that the dual-resident trust will forfeit treaty benefits unless the two contracting states can reach a mutual agreement on its exclusive residence.

3 BENEFICIAL OWNERSHIP AND TRUSTS

In tax treaties, the 'beneficial ownership' concept is especially relevant in relation to the 'passive' income articles dealing with dividends, interest and royalties. In the OECD Model, these are Articles 10-12. Sometimes, the 'beneficial ownership' concept appears in the 'Other Income' article of a treaty (Article 21 of the OECD Model).

15. In UK tax law, it is only if the rule in *Baker v. Archer-Shee*, *supra* n. 4, and not the rule in *Garland v. Archer-Shee* applies to a life interest in the income of a trust that the UK tax liability of the trustee(s) will be regarded as purely 'representative', for the purposes of applying Art. 4(1) of the OECD Model. Which of these two rules applies depends heavily on the governing law of the trust. For a full discussion, *see* 'Classifying Entities', *supra* n. 1, at 79-94, 168-170 and 210-213. The 'bare trust' concept is less simple than it might at first appear. For a full discussion of the UK position, *see* 'Classifying Entities', *supra* n. 1, at 71-79. The Australian position regarding 'bare trusts' is analysed in *Herdegen v. FCT* (1988) 20 ATR 24.

There is much debate about what 'beneficial ownership' means and how this concept limits conduit arrangements in particular and 'treaty shopping' in general.[16] It seems to be accepted, in particular in the UK, that in tax treaties, 'beneficial ownership' should not necessarily be defined by the domestic law of the relevant contracting state. The Article 3(2) reference to domestic law is therefore displaced by the context, requiring an 'international fiscal meaning' of 'beneficial ownership'.[17] This must be correct, not least because tax treaties apply in jurisdictions (notably civil law ones) where the trust concept may be unfamiliar or unknown. If treaties are to be applied in a uniform way, it is therefore inappropriate to fall back on the concept of 'beneficial ownership' as it applies in the domestic tax law, and in particular the trust law, of common law jurisdictions, such as the UK or the US.[18]

So it should be irrelevant for treaty purposes that a common lawyer instinctively regards a trustee as a fiduciary and therefore never a 'beneficial owner' (unlike a beneficiary of the trust). However, when should a trustee be seen as 'beneficial owner' for treaty purposes, bearing in mind that a trustee always acts on behalf of others[19]? Is a trustee always a pure 'conduit' or 'administrator' of income, with little real control over it and therefore not a 'beneficial owner'?[20]

16. Of course this concept is not the only tool available to counteract treaty abuse, especially now that Art. 29 of the OECD Model contains a 'principal purpose test'. For a broader recent discussion of 'beneficial ownership' as it relates to tax treaties and the problems that it raises, *see* Dietmar Gosch and Nadia Altenburg: 'Beneficial Ownership and Tax Treaties'. Chapter 22 'The Oxford Handbook of International Tax Law' ed. Florian Haase and Georg Kofler. Oxford University Press 2023, at 373-389. *See also* Jonathan Schwarz's recent discussions (dated 12 February, 2 April and 31 May 2024) in the Kluwer International Tax Blog of the UK Court of Appeal decision in *Hargreaves Property Holdings v. HMRC* [2024] EWCA Civ 365 and the Canadian Tax Court decision in *Husky Energy Inc. v. The King* 2023 TCC 167 (Can LII): https://kluwertaxblog.com/author/jonathan-schwarz. These authors do not discuss the particular issues considered in the main text regarding 'beneficial ownership' and trusts.
17. *See Indofood International Finance Ltd v. J.P. Morgan Chase Bank NA* [2006] STC 1195, a decision of the UK Court of Appeal in a non-tax case which has nevertheless heavily influenced tax thinking. The post-*Indofood* guidance of the UK tax authorities (*see* International Tax Manual INTM332050, 332060 and 504030) indicates that there will be no need to challenge 'beneficial ownership' where the recipient of a payment has an obligation to pass it on but the actual, underlying beneficial owner would be entitled to relief which is at least as generous as that available to the immediate recipient. In such cases, there is no avoidance. The UK heavily promoted the 'beneficial owner' concept when it first appeared in the 1977 version of the OECD Model. The Commentary on Arts 10-12 of the 2017 OECD Model indicates that an autonomous interpretation of 'beneficial ownership' is appropriate and its domestic law meaning is not decisive.
18. The equally authentic French version of the OECD Model uses the concept of 'bénéficiaire effectif', not 'beneficial ownership' (as used in the English version). This, and the equivalent German concept of 'Nutzungsberechtigte', are clearly not based on trust law thinking. In fact not all jurisdictions with a developed law of trusts distinguish between legal and beneficial ownership in their domestic trust law, e.g., those jurisdictions, such as Scotland and South Africa, whose legal heritage is based on both the civil and common law: *see* 'Classifying Entities', *supra* n. 1, at pp. 88-89. For a useful recent summary of what 'beneficial ownership' means in UK domestic tax law, and how this differs from its treaty meaning, *see* Buchanan, Everett and Van der Haegen 'Beneficial Ownership: Practical Applications' [12 July 2024] Tax Journal.
19. Or in the case of a charitable or other 'purpose' trust, for an object other than the trustee's own benefit.
20. *See*, for example, the November 1986 OECD Report on Double Taxation Conventions and the Use of Conduit Companies.

Where the trust is a discretionary and accumulation trust, then the trustees should be regarded as 'beneficial owners' of trust income and gains because they have no obligation to distribute income and gain to beneficiaries during the accumulation period.[21] Similar reasoning should apply to a foundation. If a discretionary trust does not contain a power of accumulation (which is rare), then it is harder to treat the trustees as 'beneficial owners', because they have an *obligation* to distribute all income and gain to beneficiaries (net of tax and trust expenses).[22]

A number of collective investment funds take the legal form of trusts, e.g., UK unit trusts and, in the US, Massachusetts business trusts. Such trusts may have a duty to distribute all income and gain to fund investors in a timely manner. Indeed, local tax rules may require or deem such a distribution if material tax at the level of the fund is to be avoided.[23] Should such trust-based funds be regarded as 'beneficial owners' of their income and gains? While their situation may seem analogous to discretionary trusts, there is a school of thought (reflected in the Commentary to the OECD Model) that they should nevertheless be regarded as 'beneficial owners' for treaty purposes, at least if they are widely held and regulated.[24] This helps to ensure the overall efficiency of collective investment funds by enabling them to claim treaty benefits.

Where a trust is a 'bare trust' or a 'life interest' trust, where beneficiaries have fully vested, current entitlements to trust income and/or gain, then it is much harder to treat the trustees as 'beneficial owners' of that income and gain for treaty purposes. This is true, in particular, where the trust gives a beneficiary an immediate pro rata entitlement to underlying income and gain of the trust.[25] In such cases, it would be logical to treat the beneficiaries themselves as 'beneficial owners' of the trust's income and gains for treaty purposes. This is similar to the approach endorsed by the OECD in the 1999 Partnerships Report, where a 'fiscally transparent' partnership is not a 'resident of a contracting state' (because it is not itself 'liable to tax' there), but its partners are liable to tax, as residents of their home jurisdictions, in respect of their shares of partnership income and gains.

21. *See* John Prebble: 'Accumulation Trusts and Double Tax Conventions' [2001] British Tax Review 69. New Zealand has added a reservation to Art. 3 of the OECD Model that trustees should be treated as beneficially owning dividends, interest and royalties on which they are taxable. Similar wording has found its way into several of New Zealand's tax treaties.
22. Even though no one beneficiary can demand a particular amount from the trustees.
23. Material tax at the level of the fund will undermine its commercial viability.
24. For a fuller discussion of whether investment funds enjoy treaty protection, *see* Martine Merten: 'Taxation of Investment Funds following the OECD Base Erosion and Profit Shifting Initiative: Parts 1 and 2' [February 2019] Bulletin for International Taxation (at 76) and May 2019 (at 252). *See also* para. 2(b) of the Protocol to the 2022 UK treaty with Luxembourg.
25. This would typically be the case where such a trust is governed by English law, because of the rule in *Baker v. Archer-Shee*, *supra* n. 4. The trust law of many other jurisdictions is consistent with that rule. However, if the governing law of a trust means that beneficiaries with fully vested interests are only regarded as entitled to a net distribution (of income less expenses) from the trustees, rather than being entitled to specific underlying trust income and gain, the UK tax authorities will still treat the trustees as 'beneficial owners' for treaty purposes, relying on *Garland v. Archer-Shee* 15 TC 693. This somewhat pragmatic approach makes sense for the reasons given in 'Classifying Entities', *supra* n. 1, at 213 fn 722. There is a special statutory exception for the income of Scottish trusts, which would otherwise be subject to *Garland v. Archer-Shee* 15 TC 693: *see* 'Classifying Entities', *supra* n. 1, at 89.

Even where it is appropriate to treat a trust beneficiary as the 'beneficial owner', the benefits of this 'look through' may be limited in some respects. Article 10(2)(a) of the OECD Model grants a reduced (5%) rate of withholding tax on dividends paid from one contracting state to a company resident in the other contracting state in respect of a non-'portfolio' shareholding held by the latter. However, the OECD Model requires the 'beneficial owner' of the dividend income to 'hold directly' those shares. If the corporate 'beneficial owner' in fact owns those shares via a 'bare' trust, it is not clear that this condition will be met, even though the trustee(s) may be little more than a nominee.[26] If the corporate beneficiary only has a vested entitlement to the income (including dividends) of the trust which owns those shares, but not to the trust capital, it will be even harder to argue that the corporate beneficiary holds those shares directly. In practice, in many treaties, the equivalent of Article 10(2)(a) of the OECD Model is drafted less restrictively. In particular, the company resident in the other contracting state must have 'direct or indirect control' of the non-'portfolio' shareholding. Depending on the facts and the nature of its beneficial interest in a trust, the corporate beneficiary may be able to demonstrate such control.[27]

Other factors may complicate the question of trustees' treaty entitlement and, in particular, 'beneficial entitlement'. Suppose that the trustees of a discretionary and accumulation trust successfully claim treaty benefits on trust income because they are subject to a standalone tax charge on trust income and gains in the jurisdiction ('A') where they are resident. Sometime later, those trustees distribute income and gain to a beneficiary resident in another jurisdiction ('B'). B has no tax treaty with the jurisdiction(s) from which the trustees derived income, etc. Jurisdiction A enables a beneficiary not resident in A to recover tax paid by the trustees in A to the extent that the distribution to that beneficiary is sourced from income on which it would not have been taxed in A if it had received it directly rather than via the trust. The logic of such tax relief is that imposing trust-level tax in A on non-A income distributed via the trust to a non-A-resident is extraterritorial taxation, from A's perspective.[28] This logic is fine so far as it goes[29] but what if the A-resident trustees have claimed treaty relief at source

26. *Hardoon v. Belilos* [1901] AC 118 (UK House of Lords).
27. This would seem much easier where the corporate beneficiary has a vested current interest in both the income and the capital of the trust. Art. 10(2)(a)(ii) of the 2016 US Model actually says that shares may be 'held directly' via a 'transparent' entity. The Protocol to the 2015 Australia-Germany treaty says much the same.
28. UK tax law contains such a relief. In fact, it is an administrative (or extra-statutory) concession, ESC B18. Limited aspects of it were reviewed recently by the UK Court of Appeal in *Murphy v. HMRC* [2023] EWCA 497. This decision is discussed elsewhere in this book by Dr Mark Brabazon SC. Indeed, Australia has a similar rule to ESC B18, in s. 99D Income Tax Assessment Act 1936. For a fuller discussion of ESC B18, *see* 'Classifying Entities', *supra* n. 1, at 101-102. For a discussion mainly focused on the administrative law aspects, *see* Stephen Daly: 'Murphy v HMRC (Court of Appeal): A Positive Concession?' [2023] BTR 515-525.
29. This logic shows an important difference between trust taxation and corporate taxation. Corporate taxation may well have an extraterritorial tax effect because the company is a separate taxpayer which is not normally taxed as a representative of its members (although they bear the economic burden of taxation at company level). Therefore, if a company resident in A receives non-A income, it would typically be subject to corporate income tax in A on that income. If it then used that income to pay a dividend to a non-A-resident shareholder, that shareholder cannot normally recover any of the corporate income tax paid in A on that income. As a

in respect of that non-A income, on the basis that they are liable to tax on it in A? The rule in A allowing the beneficiary resident in B to recover some or all of the tax imposed in A undermines the basis on which the source jurisdiction granted treaty relief to the trustees. This is especially true where B has no treaty with the source jurisdiction. The problem remains even if the subsequent distribution by the discretionary trust is not motivated by tax avoidance.

Interestingly, other jurisdictions have to some extent anticipated and addressed such situations, e.g., in Article 26(3) of the 2006 treaty between Canada and Finland.[30]

4 TREATY RELIEF ON TRUST DISTRIBUTIONS

When trustees make a distribution, that distribution may attract local withholding tax. This is especially likely where a discretionary trust distribution is regarded (notably in the UK) as a *separate* 'source' of income and gain, which is distinct from the underlying trust income and gain. That separate source comes into being when the trustees exercise their discretion.[31] Italy may regard the trust distribution as a dividend if (*see* 2) it treats the trust as a corporate entity. This may give rise to withholding tax. Other jurisdictions (notably Australia and the US) may take a different approach because they do not see the trust distribution as a separate income source from underlying trust income and gain.

In principle, a beneficiary receiving a trust distribution which is seen as a separate income source can claim relief from source-based tax under the 'Other Income' Article of the relevant treaty (Article 21 of the OECD Model). However, it is

non-A-resident, the shareholder is unlikely to be eligible for (any) recoverable 'imputation credit' granted by A to reflect corporate-level tax paid in A on income which it later distributes.
30. Treaty benefits are denied to 'any company, trust or other entity that is a resident of a Contracting State *and is beneficially owned or controlled, directly or indirectly*, by one or more persons who are not residents of that State, if the amount of the tax imposed on the income or capital of the company, trust or other entity by that State (after taking into account any reduction or offset of the amount of tax in any manner, including a refund, reimbursement, contribution, credit or allowance to the company, trust or other entity *or to any other person*) *is substantially lower than the amount* that would be imposed by that State, if all of the shares of the capital stock of the company or all of the *interests in the trust or other entity*, as the case may be, were beneficially owned by one or more individuals who were residents of that State' [emphasis added]. In relation to a discretionary trust, is the trust 'beneficially owned or controlled, directly or indirectly' by the discretionary beneficiaries? In classical trust thinking, such beneficiaries only have the right to be considered by the trustees as potential recipients of benefit from the trust. They do not 'own or control' anything. However, to give purposive effect to this kind of provision, a court may be inclined to read it more broadly. *See* the decision of the Norwegian Supreme Court in 2002 in *State of Norway (Central Office for Large Companies) v. Olsen and others: Re the Ptarmigan Trust* 5 ITELR 77, where the court applied the Norwegian controlled foreign company rules to a Liechtenstein discretionary trust. It did so on the basis that it was 'owned' at least 50% by Norwegian-resident discretionary beneficiaries because the latter derived benefit from the trust (including a growth in its value), whether or not the trust made distributions.
31. In this respect, *see*, for example, UK cases such as *Cunard's Trustees v. IRC* 27 TC 122. For further discussion of such cases, *see* 'Classifying Entities', *supra* n. 1, at 99, and especially fn 316. If the beneficiary's interest in the trust is such (e.g., a vested beneficial interest in income and capital) that it is already treated as entitled to a share of underlying income and gain (whether or not distributed), there may be no withholding tax on an actual distribution.

standard UK treaty policy to exclude trust distributions from that Article.[32] Canada pursues a similar policy. Sometimes, a UK treaty (e.g., the treaties with Hong Kong and Spain) permit the beneficiary resident in the other jurisdiction to treat the trust as in effect 'transparent', even if it is a discretionary trust. A trust distribution can then be treated as 'sourced' directly from underlying trust income and gain.[33] This can in turn trigger UK tax relief/a refund, depending on what that income and gain comprise.[34]

5 THE IMPACT OF ARTICLE 1(2) OECD MODEL ON THE TAXATION OF TRUSTS

Article 1(2) was first included in the OECD Model in 2017, as a result of the conclusions of BEPS Action 2, which addresses some of the double taxation and double non-taxation issues associated with 'hybrid mismatches'. It builds on the much-criticised conclusions of the 1999 OECD Partnerships Report.[35] These partly addressed hybrid mismatch issues and their impact on tax treaties, but only in relation to partnerships and only by making changes to the Commentary on the OECD Model rather than the Model itself. Article 1(2) extends to 'an entity or arrangement'. It is not limited to partnerships and can cover trusts.

Article 1(2) reads: 'For the purposes of this Convention, income derived by or through an entity or arrangement that is treated as *wholly or partly fiscally transparent under the tax law of either Contracting State* shall be considered to be income of a resident of a Contracting State *but only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State* [emphasis added]'.

Article 1(2) does not, however, prevent a contracting state taxing its residents (e.g., a trustee or a beneficiary or a settlor) as if the treaty did not apply. This 'saving' clause, like Article 1(2) itself, is heavily influenced by equivalent provisions in the US Model Tax Treaty. Limited exceptions to the 'saving' clause enable residents of a contracting state to rely on parts of the treaty (e.g., the Articles dealing with double taxation relief and non-discrimination) when computing their tax liability in that state. Standard UK tax treaty policy is now to include wording similar to Article 1(2) and (3), although some jurisdictions (e.g., France and India) have resisted this, not least in their treaties with the UK. Furthermore, Article 3 of the 2016 OECD Multilateral Instrument

32. Of course a beneficiary may still be able to recover UK tax imposed by virtue of ESC B18, discussed in *supra* n. 28.
33. *See* Art. 20(2) of the 2010 treaty with Hong Kong and Art. 20(2) of the 2013 treaty with Spain.
34. This approach is similar to ESC B18, discussed in *supra* n. 28, but is spelled out in the treaty. Art. 20(2) of the treaty with Spain is clearer in this respect than Art. 20(2) of the treaty with Hong Kong. ESC B18 contains supporting detail about allocating underlying income and gains to trust distributions, as well as the procedure for claiming relief. That level of detail is lacking in the treaties with both Hong Kong and Spain. Presumably, where Italy taxes a trust as a company, distributions may attract withholding tax relief under Art. 10 of the OECD Model (or equivalent) or even under the EU Parent-Subsidiary Directive (*see supra* n. 11).
35. For a summary of those criticisms, *see* Ton Stevens 'Taxation of International Partnerships', Chapter 25, The Oxford Handbook of International Tax Law, *supra* n. 16, at 433-454.

(MLI) in effect inserts wording similar to Article 1(2) and (3) in existing treaties between MLI signatories.[36]

Article 1(2) will be of particular relevance where the state of residence of a trust beneficiary or of a settlor taxes that beneficiary or settlor on the basis that the trust is 'wholly or partly fiscally transparent'.[37] If so, then Article 1(2) requires the state where any trust income and gain is sourced to give relief under any treaty between that state and the residence state of the beneficiary/ settlor but only to the extent that the residence state treats the income and gain as liable to tax in the hands of a resident.[38] It is not relevant that the source state may not itself regard the trust as wholly or partly transparent. However, it is the source state which determines whether and to what extent the trust derives income and gain from that state. It also determines the nature of that income and gain, as well as the timing of any source state tax charge. In short, Article 1(2) is a compromise between source state and residence state. The former gets to determine certain issues about the source state tax charge but cannot withhold treaty relief simply because it regards the trust as non-'transparent', while the residence state regards it as 'transparent'.

A number of criticisms have been levelled at Article 1(2) and (3). A detailed examination of these is beyond the scope of this chapter,[39] which instead focuses on how these provisions work in relation to trusts.

A trust should be treated as an 'entity or arrangement' for the purposes of Article 1(2).[40] More problematic is the meaning of 'fiscally transparent'. This is not defined in Article 1(2) itself, although the words 'wholly or partly' suggest that different answers to the transparency question can apply to different parts of a trust fund. For example, a trust fund may be held on the basis that the income and capital of half of it is fully vested in favour of a single beneficiary, while the other half is held on discretionary and accumulation trusts.

Paragraphs 9-10 of the Commentary to Article 1 of the 2017 OECD Model provide some guidance on the meaning of 'fiscal transparency'.

Paragraph 9 states: 'The concept of "fiscally transparent" ... refers to situations where, under the domestic law of a Contracting State, the income (or part thereof) of the entity or arrangement is not taxed at the level of the entity or arrangement but at the level of the persons who have an interest in that entity or arrangement. This will normally be the case where the amount of tax payable on a share of the income of an

36. The UK is a signatory to the MLI, which it has ratified and which came into force in the UK on 1 October 2018. The terms of ratification of the MLI will determine when and how a state has agreed to insert the equivalent of Art. 3 of the MLI into its existing treaties. For example, it is clear that the UK's ratification of the MLI does not override the special wording regarding transparent and hybrid entities in the 2009 UK-France treaty. That wording is discussed in detail in 'Classifying Entities', *supra* n. 1, at 187-200.
37. The meaning of this concept is discussed further below, in the main text.
38. So relief may not be available if the trust is a 'reverse hybrid' i.e., 'opaque' in the jurisdiction where the beneficiary/settlor is resident but 'transparent' in the source jurisdiction.
39. For a much fuller discussion, *see* 'Classifying Entities', *supra* n. 1, at 155-165, as well as Stevens, 'Taxation of International Partnerships', *supra* n. 35, at 445-447.
40. There is debate about the difference between an 'entity' and an 'arrangement'. At the very least, a trust should be an 'arrangement' between settlor, trustee and beneficiary/ies, whether or not the trust is a legal person.

entity or arrangement is determined separately in relation to the personal characteristics of the person who is entitled to that share so that the tax will depend on whether that person is taxable or not, on the other income that the person has, on the personal allowances to which the person is entitled and on the tax rate applicable to that person; also the character and source, as well as the timing of the realisation, of the income for tax purposes will not be affected by the fact that it has been earned through the entity or arrangement. The fact that the income is computed at the level of the entity or arrangement before the share is allocated to the person will not affect that result. States wishing to clarify the definition of "fiscally transparent" in their bilateral conventions are free to include a definition of that term based on the above explanations'.

Paragraph 10 states: 'In the case of an entity or arrangement which is treated as *partly fiscally transparent* [emphasis added] under the domestic law of one of the Contracting States, only part of the income of the entity or arrangement might be taxed at the level of the persons who have an interest in that entity or arrangement as described in [the previous paragraph] whilst the rest would remain taxable at the level of the entity or arrangement. This, for example, is how some trusts and limited liability partnerships are treated in some countries (i.e., in some countries, the part of the income derived through a trust that is distributed to beneficiaries is taxed in the hands of these beneficiaries whilst the part of that income that is accumulated is taxed in the hands of the trust or trustees; similarly, in some countries, income derived through a limited partnership is taxed in the hands of the general partner as regards that partner's share of that income but is considered to be the income of the limited partnership as regards the limited partners' share of the income …)'.

The Commentary therefore focuses simply on whether or not underlying income of the entity or arrangement (e.g., a trust) is taxed at the level of those with an 'interest' (undefined) in it on the same basis (and at the same time),[41] while retaining the same source and character as if the holder of that 'interest' had been directly entitled to the underlying income.[42] The holder of that 'interest' need not be entitled to claim a share of any tax losses of the entity or arrangement. There is also no requirement that the relevant tax law treat the holder of the 'interest' as owning a share of the assets of the entity or arrangement.

This is quite a limited conception of 'fiscal transparency'. Furthermore, the Commentary sheds no light on whether a tax rule attributing income and gain of a trust

41. The partial transparency example in para. 10 of the Commentary is slightly confusing. It contrasts trust income taxable on a beneficiary on *distribution* with income accumulated at trust level. The classic example of a transparent trust is where the beneficiary is taxable on its share of underlying trust income as it arises to the trustee(s) *and whether or not it is distributed*. Of course para. 10 could be hinting at a more limited, alternative meaning of 'transparency' where a beneficiary (e.g., of a discretionary trust) is not taxed on undistributed trust income but an actual distribution is taxed in its hands as if sourced directly from underlying trust income and gains, ignoring the trustee(s). An example of this thinking is the UK's Extra-Statutory Concession B18: *see* s. 3. Other examples are 'simple' and 'complex' trusts in the US: *see* 'Classifying Entities', *supra* n. 1, at 227.
42. For further discussion, *see* 'Classifying Entities', *supra* n. 1, at 115-119. Art. 1(2) still seems to apply if the income is liable to tax in the residence state of the 'interest' holder even though that state classifies it differently to the source state, or even (?) exempts it.

to the grantor/settlor of the trust is a form of 'fiscal transparency'. This is discussed further below.[43]

The Commentary suggests that, for a trust to be 'fiscally transparent', the holder of an 'interest' in it must be entitled to trust income and gain of the same character *and* arising at the same time (i.e., not on a deferred basis) as if the underlying income and gain had been derived directly by the holder of that 'interest'.[44] In the context of trusts, especially discretionary trusts, this seems rather restrictive. A discretionary beneficiary may be taxed on a trust distribution as if it had the same character and source as the trust's underlying income, etc. Surely, that should be 'fiscal transparency' for Article 1(2) purposes, even if: (i) that distribution requires a trustee decision which occurs after the underlying income, etc., arose to the trust; and (ii) the beneficiary only recognises income in its residence state *after* that decision-cum-distribution has been made?

Consequently, there is a lot of uncertainty about what 'fiscal transparency' means for the purposes of Article 1(2), especially as it relates to trusts (as it clearly can do).[45] It is helpful to look at further examples of different kinds of trust.

To take a 'simple' case, suppose that a trust beneficiary has a fully vested entitlement to the income of a trust. It is taxed in its home jurisdiction on the basis that it is entitled to underlying trust income as it arises to the trustee(s), whether or not that income is distributed. This is the classic UK tax law treatment of a holder of a life

43. Importantly, such taxation can arise even where the grantor/settler has no significant ongoing legal or economic interest in the trust, even if it has some ongoing de facto control.
44. This is of course how 'transparent' taxation classically works in relation to a partnership, but not necessarily a trust. Under the treaty, the source state will, as usual, determine the character and source of the income and gain.
45. Interestingly, similar issues arise in relation to the rules in the OECD's 'Pillar Two' corporate minimum tax regime regarding 'transparent' entities, which can include trusts. A trust can be an 'entity', and therefore a 'constituent entity' within a multinational group, for the purposes of the Pillar Two rules: *see* the definition of 'Entity' in Art. 10.1.1 of the Pillar Two Model Rules ('the GloBE rules'), which includes 'an arrangement that prepares separate financial accounts, such as a partnership or trust'. *See also* the UK transposition of Pillar Two in s. 231(1) Finance (No. 2) Act 2023. It is beyond the scope of this chapter to discuss these rules in detail but the following should be noted. Art. 10.2.1 of the GloBE rules defines a 'flow-through entity' (FTE) as an entity that is 'fiscally transparent with respect to its income, expenditure, profit or loss in the jurisdiction where it was *created* [emphasis added]'. Art. 10.2.1(a) states that a FTE is a 'Tax Transparent Entity' with respect to its income, expenditure, profit or loss '*to the extent that it is fiscally transparent in the jurisdiction in which its owner is located* [emphasis added]'. Article 10.2.2 says that an entity is 'fiscally transparent' under a jurisdiction's laws if 'that jurisdiction treats the income, expenditure, profit or loss of that Entity as if it were derived or incurred *by the direct owner of that Entity in proportion to its interest in that Entity* [emphasis added]'. The revised 2024 Commentary on the GloBE rules discusses these definitions. In particular, they cover cases of partial transparency i.e., where not all of an entity's income is subject to flow-through treatment. It is also not necessary that losses of the entity, as well as its profits are subject to flow-through treatment in order for there to be 'fiscal transparency'. It is not clear that the definition in Art. 10.2.2 covers cases where trust income is attributed on a current basis to a settlor. In particular, the latter may well not be an 'owner' with an 'interest' in the entity. Similar questions arise in relation to a discretionary trust … even if it makes distributions which are treated, for the purposes of taxing beneficiaries, as if directly sourced from underlying trust income. Are those beneficiaries 'owners' and do they have an 'interest' in the trust for these purposes? Furthermore, even if such a trust is 'fiscally transparent', how do the GloBE rules work if income arises to the trust in Year 1 but is only distributed in Year 2?.

interest 'in possession' in an English law trust. It should amount to 'fiscal transparency' for the purposes of Article 1(2), because the holder of the beneficial interest is being taxed on income of the same character as the trust income at the same time as it arises to the trust.

A harder scenario is where a trust beneficiary has no vested entitlement to its underlying income (e.g., under a discretionary trust). However, if it receives a distribution from the trust, its home jurisdiction taxes it as if it had received a pro rata share of the underlying trust income. This could be some time after the underlying income arose to the trust. Is this 'fiscal transparency' for Article 1(2) purposes? If so, the beneficiary may seek treaty relief at source on underlying trust income distributed to it, but only some time after that income arose to the trustee(s). That could expose the source state to treaty relief claims via Article 1(2) long after income from the source state arose to the trust.

Another difficult situation arises where a settlor is taxed in its home jurisdiction as if it is entitled to some or all of a trust's income and gain, whether or not distributed. This probably means that the settlor is subject to current taxation, even if it has no ongoing legal or economic interest in the trust. Are such attribution rules examples of 'fiscal transparency' for Article 1(2) purposes or are they simply anti-avoidance rules which are unaffected by the treaty, so that the settlor cannot claim relief from the source state using Article 1(2)? Should the outcome depend on whether the home state of the settlor treats it for tax purposes as owning a share of the underlying trust fund?[46] This is an unresolved question. This writer considers that this scenario should be regarded as 'fiscal transparency' for Article 1(2) purposes, at least if the settlor/grantor is treated as entitled to the trust income or an amount computed directly by reference to it. This approach is consistent with what Article 1(2) is seeking to achieve and does not prejudice the interests of the source state by creating unacceptable double non-taxation.[47] Others disagree.

Of interest in this respect is the Exchange of Notes to the 2001 UK tax treaty with the US.[48] This was the first UK tax treaty to contain language similar to what is now Article 1(2). The equivalent language in that treaty is Article 1(8), which is based on the 1996 US Model Treaty. It uses the words 'fiscally transparent' which are not defined in the treaty itself. However, the Exchange of Notes states that both the UK and the US will regard the tax charge on attributed income and gain arising under some (though not all) of their domestic anti-avoidance or anti-deferral rules as a form of 'fiscal transparency' for Article 1(8) purposes. This is a very helpful gloss on the meaning of Article

46. This can be the result of applying the US 'grantor trust' rules. By contrast, the UK rules for attributing income or gain of a 'settlement' do not routinely treat the 'settlor' as owning part of the trust fund.
47. Even though classically, 'fiscal transparency' requires the taxpayer to have a real economic interest in the trust, which is unlikely in this situation. For a more detailed discussion, *see* 'Classifying Entities', *supra* n. 1, at 118 fn 395, 157-158 and 178-180. *See also* Mark Brabazon: 'International Taxation of Trust Income: Principles, Planning and Design', Cambridge University Press 2019, at 220-229.
48. SI 2002/2848.

1(8).[49] The Exchange of Notes was signed by both contracting states in conjunction with the treaty and is therefore highly authoritative. It would be helpful if the OECD Commentary contained similar clarification.

If a trust is 'fiscally transparent' for Article 1(2) purposes in the residence jurisdiction of a beneficiary, which treaty can that beneficiary rely on if the source state ('S') has a tax treaty with both the residence jurisdiction of the trustee(s) ('T') and (if different) the residence jurisdiction of the beneficiary ('B')? Suppose that the treaty between S and T is less generous than the treaty between S and B.[50] Nevertheless, OECD thinking going back to the 1999 Partnerships Report is that the beneficiary resident in B can rely directly on the S-B treaty if that gives it a better outcome, even though it has not invested directly in S but only indirectly via the trust located in T. This disadvantages the source state. Although there are different schools of thought on this, it is surely better that the S-T treaty should always govern because that reflects the chosen investment structure. Of course, the S-T treaty may sometimes give a better outcome than the S-B treaty but whether it does or does not should not matter.

As already mentioned, if a trust beneficiary or a settlor can rely on Article 1(2), that will only generate treaty relief in the jurisdiction where income or gain is sourced (subject to satisfying any other relevant treaty conditions). Article 1(3) preserves the taxing rights of the jurisdiction where the trustee(s) is resident. So there is a real risk of double taxation of the same income and gain on the basis of residence, at both trust level and settlor/beneficiary level. The jurisdiction where the trustee(s) is resident is not required to accept the treatment of the trust as 'transparent' in any other relevant jurisdiction.

Before leaving Article 1(2), one other weakness should be flagged. Suppose that royalty income is paid from the source state ('S') to a trust whose trustee(s) are resident in state T. The trust has beneficiaries resident in state B, which regards the trust as 'transparent' for Article 1(2) purposes, even though neither state S nor state T does. In principle, the beneficiaries can rely on Article 1(2) to claim treaty relief from S. However, are the beneficiaries 'beneficial owners' of that royalty income for the purposes of the S-B treaty, assuming that it is based on Article 12 of the OECD Model? Article 12(1) states that 'Royalties *arising in a Contracting State and beneficially owned by a resident of the other Contracting State* shall be taxable only in that other State' (emphasis added).[51] One school of thought[52] states that the source state should

49. Article 1(8) and the relevant part of the Exchange of Notes are further discussed in 'Classifying Entities', *supra* n. 1, at 176-181.
50. For example, the treaty between S and T may allow S to impose a higher rate of withholding tax on passive income, or contain an expanded 'permanent establishment' definition which would catch a so-called service p.e. in S.
51. The wording is essentially the same in Art. 11(1) of the OECD Model dealing with 'Interest'. Article 10 ('Dividends') is expressed differently. Article 10(1) states that 'Dividends *paid by a* company which is a resident of a Contracting State *to a resident of the other Contracting State* may be taxed in that other State' [emphasis added]. Article 10(2) then preserves the right of the source state to tax the dividend but typically limits it where 'the beneficial owner of the dividends is a resident of the other Contracting State'.
52. The US appears to take this position (at least post-2000), even though Art. 1(2) originates in the US Model Treaty.

determine who is the 'beneficial owner'. However, relying on the domestic law of the source state[53] risks negating the benefit and purpose of Article 1(2) in a typical hybrid entity situation where the source state regards a trust as non-'transparent' but the residence state of the beneficiaries does not. Surely the clear intent of Article 1(2) is that the transparency analysis of the beneficiaries' residence state should prevail in that situation? Therefore, 'beneficial owner' should be interpreted independently of the domestic law of the contracting states in general and of the source state in particular. This reflects the clear purpose of Article 1(2).[54] So if a beneficiary (or indeed a settlor) can invoke Article 1(2) on the basis of 'fiscal transparency', that person should prima facie be the 'beneficial owner'.[55]

There is an added complication in relation to the 'Dividend' Article. As noted in footnote 51, this applies where a dividend is *paid* by a company resident in one contracting state *to a resident of the other contracting state*. The latter state can tax the dividend, but the source state can too: *see* Article 10(2). However, Article 10(2) limits source state taxation where the 'beneficial owner' is a 'resident of the other Contracting State'. How does this work in a three-state situation where (i) a dividend is paid by a company resident in state A to a trustee resident in state B (where A and B regard the trust as non-'transparent') but (ii) the beneficiary is resident in state C (which regards the trust as 'transparent' and treats the beneficiary as liable to tax on trust income as it arises)? Assume that both B and C have a tax treaty with A based on the OECD Model. The resident of state C should be able to claim treaty relief in state A by virtue of Article 1(2) and, for the reasons given above, should be regarded as 'beneficial owner' of the dividends. However, is the dividend 'paid to' a resident of state C when it is actually paid to a trustee resident in state B and not to the beneficiary resident in state C? The A-C treaty needs to be read purposively so that the dividend is treated as 'paid to' the state C-resident 'beneficial owner'. Otherwise, it is hard to see how Article 10 of the A-C treaty can apply. The A-B treaty does not assist because the beneficiary is not resident in state B.

6 DOUBLE TAXATION RELIEF AND TRUSTS

The preceding discussion makes clear that the same income and gain of a trust may be subject to tax at source, at the level of the trust itself, at beneficiary level (with or without a trust distribution) and at grantor/settlor level too. Some of this tax burden can be alleviated by, for example, locating the trustee(s) in a low-tax jurisdiction. This is common. Treaty relief from taxation at source may be available, if necessary by relying on Article 1(2) of the OECD Model. However, what relief does the OECD Model provide for any remaining double taxation?

53. As per Art. 3(2) of the OECD Model.
54. Put another way, this situation triggers the Art. 3(2) proviso that the 'context requires' an interpretation of 'beneficial owner' that is not based on a contracting state's domestic law.
55. Of course, if that person is itself an agent, nominee or conduit for the relevant income, there may be additional grounds for not treating it as 'beneficial owner'. However, that has nothing to do with interpreting Art. 1(2). For additional discussion, *see* 'Classifying Entities' *supra* n. 1, at 159.

A key initial question is whether a 'resident' of a treaty state 'derives income' from the trust for the purposes of Articles 23A and B of the OECD Model, which deal with double taxation relief? Unless a person 'derives income' from the trust, there is no double taxation relief. This raises important follow-on questions.

If Article 1(2) of the OECD Model enables a beneficiary with a vested interest in trust income to claim treaty relief in respect of underlying income on the basis that the trust is 'transparent', that person 'derives' that income, etc., for the purposes of Articles 23A and B, because it is liable to tax on it in its residence jurisdiction, whether or not that income is distributed to it. If the purpose of Articles 23A and B is to be fulfilled, then the word 'derive' should not require physical receipt of that income. Similarly, if a settlor can rely on Article 1(2) where trust income and gain is attributed to it,[56] then it too should be treated as 'deriving' that income, even though it typically has no economic entitlement to it.

In any case, relief under Articles 23A and B is limited. In particular, there is no foreign tax credit or exemption for tax imposed on a trustee, beneficiary or settlor *solely* on the basis of residence, e.g., via the 'saving clause' in Article 1(3) of the OECD Model. This is because of the following wording in Articles 23A(1) and 23B(1): '(*except to the extent* that these provisions [of the treaty] allow taxation by that other State *solely* because the income is also income derived by a resident of that State ...)' [emphasis added]. This wording was added to the OECD Model for clarification in 2017.

This is a serious weakness, given the potential for competing residence-based tax claims on the same trust income and gain. Interestingly, the Exchange of Notes to the 2001 UK-US treaty mentioned in section 5 also seeks to improve the double taxation relief position under Article 24 of that treaty, where both states tax the same trust income solely on the basis of residence (e.g., where the US taxes the grantor on that income while the UK taxes a beneficiary). In particular, in certain situations one contracting state is to allow its residents relief for residence-based taxation in the other state on the same income. This is unusual.[57]

One final point to note is that some residence states will deny double taxation relief for source state tax anyway if it is imposed on a different person to the one claiming relief (e.g., if the source state taxes the trustee but the relief is claimed by a beneficiary because its state of residence treats the trust as 'transparent'). Not all states take this approach. For example, the UK foreign tax credit rules focus[58] on whether the tax for which relief is claimed is imposed *on the same income or gain* in the state of source. If so, the precise identity of the taxpayer in that state does not matter.

56. *See* the earlier discussion in s. 5.
57. For a detailed discussion, *see* 'Classifying Entities', *supra* n. 1, at 181-185. *See also* Brabazon 'International Taxation of Trust Income', *supra* n. 47, at 244-250.
58. Section 9 Taxation (International and Other Provisions) Act 2010. It is always important to check the interplay between double taxation relief under the relevant domestic law and under a treaty. The latter may give better relief than domestic law but not always. The precise treaty wording will be key.