International Fiscal Association

# Post BEPS Treaties and Tax Certainty under the MLI

## Can Tax Certainty be achieved with a Policy of Abuse Prevention in post BEPS World?

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# Content

# Some preliminary remarks

# Problem of abuse prevention – Pre BEPS OECD Commentaries

➢ The main milestones

- **1977** OECD Commentary
- **1986** OECD “Conduit Report”
- **1992** update of the OECD Commentary
- **2003** update of the OECD Commentary
- **2014** update of the OECD Commentary

# Problem of abuse prevention – Pre BEPS OECD Commentaries

- *"The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons.* ***It is also a purpose of tax conventions to prevent tax avoidance and evasion"*** (OECD Comm. para. 7 ad Art. 1)

- «*It is also important to note that the extension of double taxation conventions increases the risk of abuse by facilitating the use of* ***artificial legal constructions*** *aimed at securing the benefits of both the tax advantages available under certain domestic laws and the reliefs from tax provided for in double taxation conventions*» (OECD Comm. para. 8 ad Art. 1)

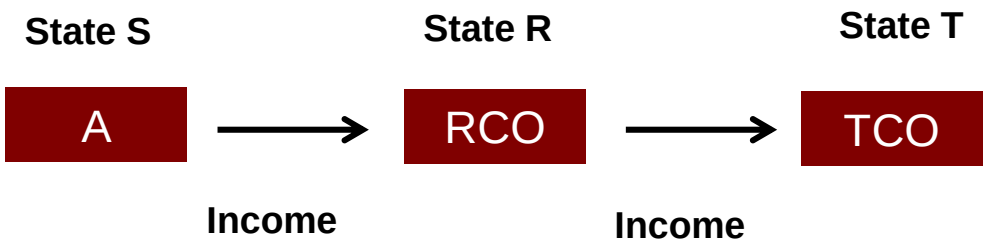
# Problem of abuse prevention – Pre BEPS OECD Commentaries

- **Conduit case:** *«This would be the case, for example, if a person (whether or not a resident of a Contracting State), acts through a legal entity created in a State essentially to obtain treaty benefits that would not be available directly (Comm. para. 9 ad Art 1)*

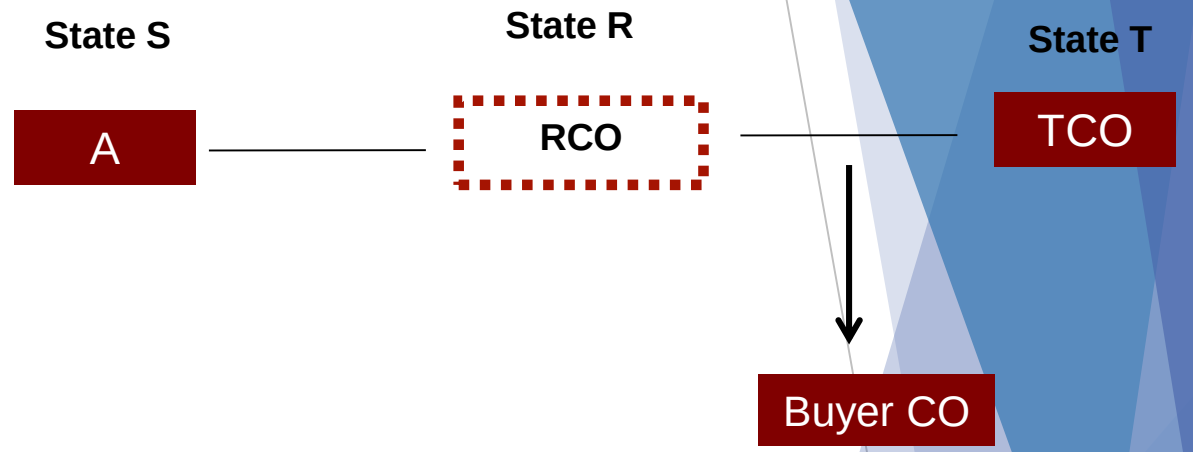
- **Restructuring case:** *« Another case would be an individual who has in a Contracting State both his permanent home and all his economic interests, including a substantial shareholding in a company of that State, and who, essentially in order to sell the shares and escape taxation in that State on the capital gains from the alienation (by virtue of paragraph 5 of Article 13), transfers his permanent home to the other Contracting State, where such gains are subject to little or no tax» (Comm. para. 9 ad Art 1)*

# Forms of treaty abuse scheme - Examples

**Dividend/interest/royalties**
**Conduit cases**



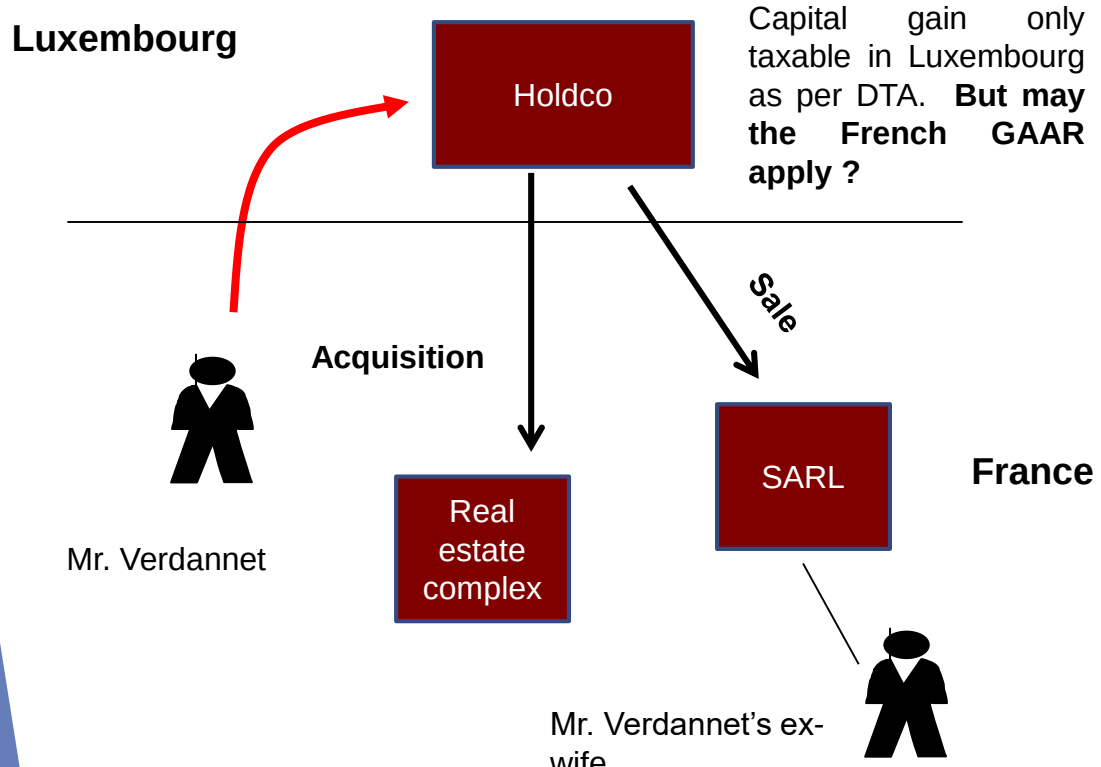

**Capital gains cases**



# Abuse and interpretation - Relevance of preambles ?

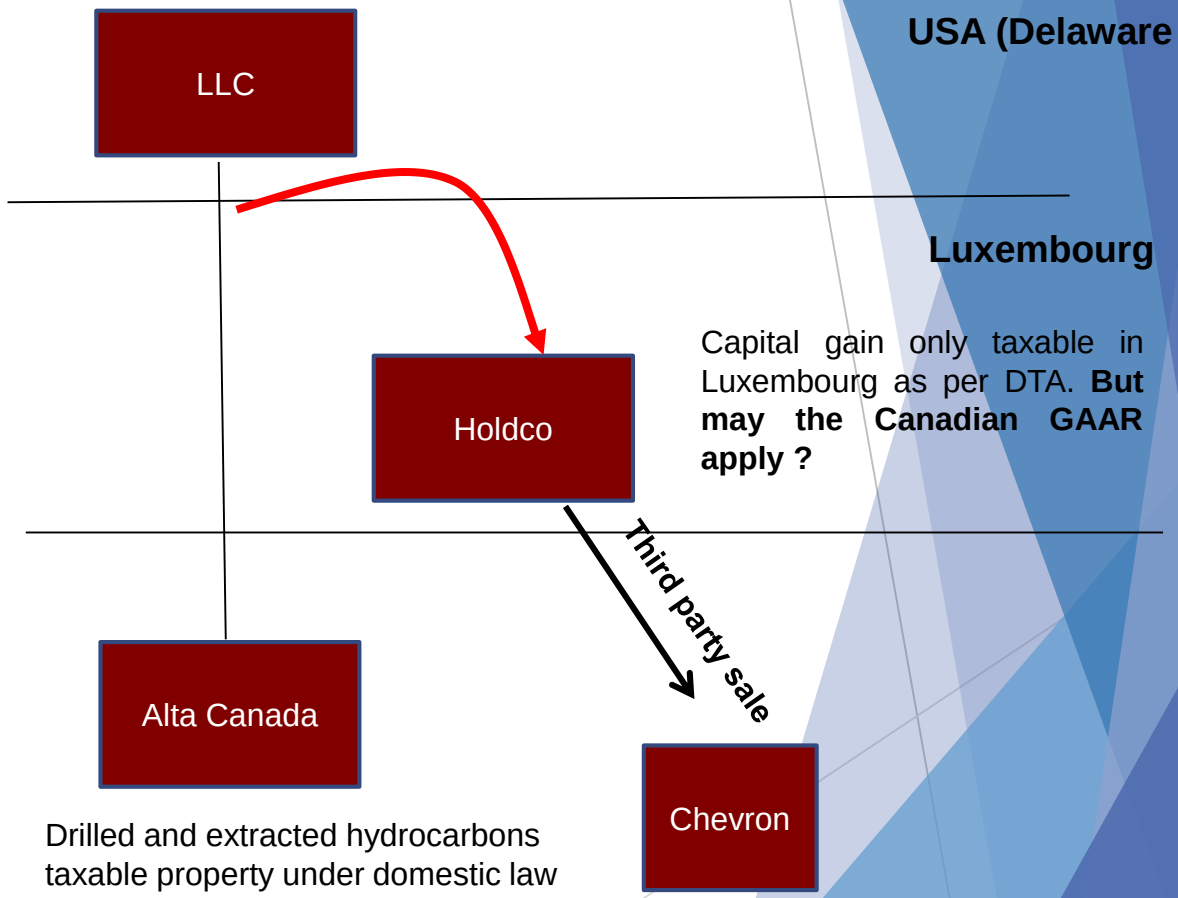
## Re Verdannet (France)

Conseil d'Etat, 25 October 2017 ( 20 ITLR 832)




## Alta Energy (Canada)

Tax Court, 22 August 2018



| Verdannet (France) | Alta Energy (Canada) |
| --- | --- |
| **Conseil d'Etat:** *"The States that are parties to the Franco-Luxembourg tax treaty cannot be regarded as admitting, in the* ***distribution of the power of taxation, the application of its provisions to situations arising from artificial transactions devoid of any economic substance****"* | *"A tax treaty is a multi-purpose legal instrument. The preamble of the Treaty states that the two governments desired "to conclude a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital." While indicative of the general purpose of the Treaty,* ***this statement remains vague regarding the application of specific articles of the Treaty. Under the GAAR analysis, the Court must identify the rationale underlying Article 1, 4 and 13, not a vague policy supporting a general approach to the interpretation of the Treaty as a whole".***<br><br>***"There is nothing in the Treaty that suggests that a single purpose holding corporation, resident in Luxembourg, cannot avail itself of the benefits of the Treaty****. There is also nothing in the Treaty that suggests that a holding corporation, resident in Luxembourg, should be denied the benefit of the Treaty because its shareholders are not themselves residents of Luxembourg"* |

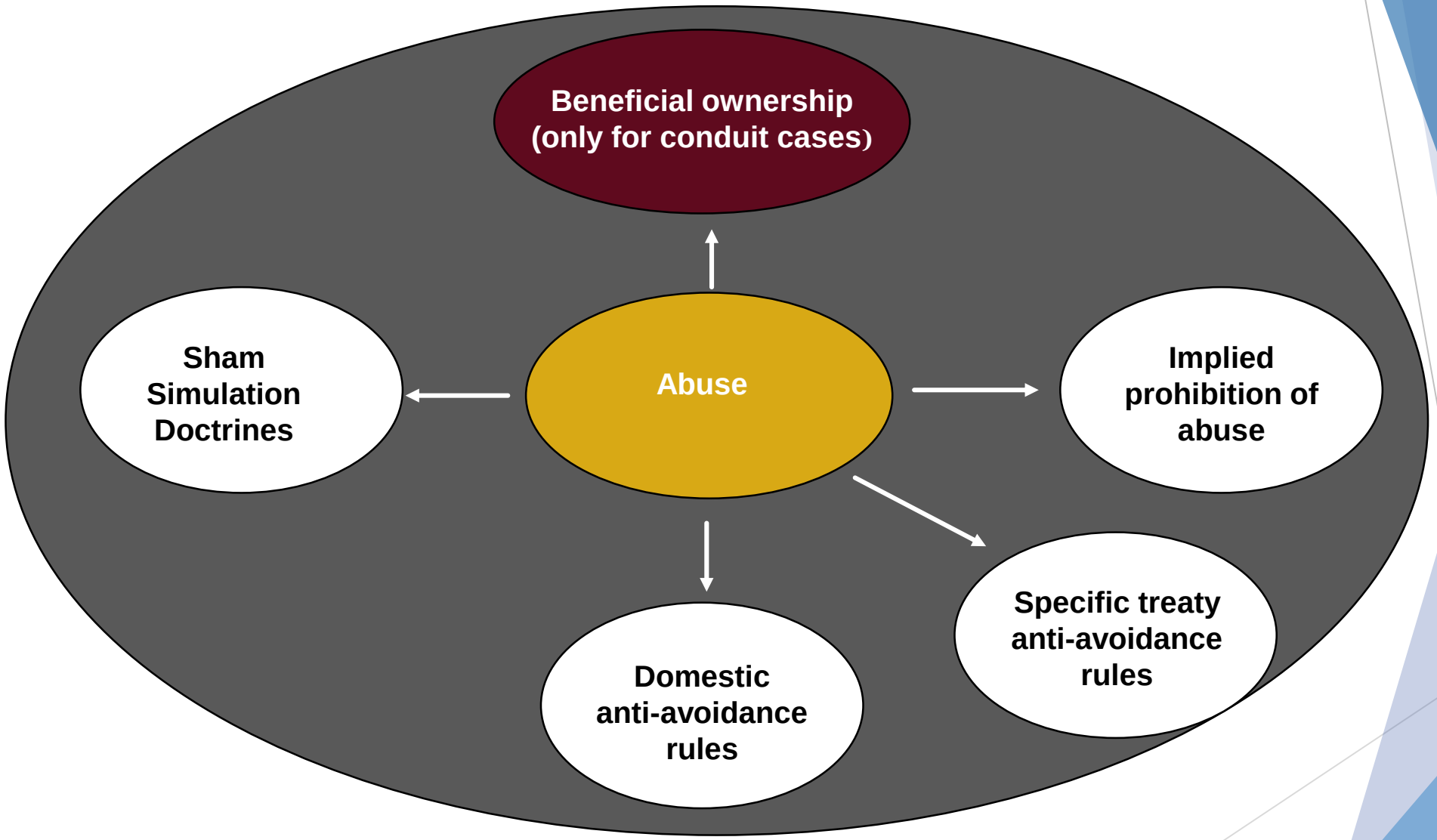
# Distinction between treaty shopping and “round-tripping”

- **Union of India v. Azadi Bachao Andolan**: *« Many developed countries tolerate or encourage treaty shopping, even if it is unintended, improper or unjustified, for other non-tax reasons, unless it leads to a significant loss of tax revenues”*

- **Vodafone International Holdings B.V. v. Union of India**: *« if a structure is used for circular trading or round tripping (….) should be discarded by applying the test of fiscal nullity »*

- **Verdannet, France, Conseil d’Etat:** *« But the primary function of these treaties, beyond this immediate purpose, is to facilitate international economic exchanges (…). It is, therefore, part of their very logic that they be read as not intending to apply to taxpayers who artificially create the conditions of foreignness allowing them to claim, according to a literal interpretation, the benefit of their clauses”*

# Main pre-BEPS responses to tax treaty abuse



# BEPS package on tax treaty abuse

# BEPS package on tax treaty abuse

- Introduction of a new preamble into the OECD Model Tax Convention **(minimum standard)**
- Introduction of a Principal Purposes Test into the OECD Model Tax Convention (art. 29(9 OECD MC) **(minimum standard)**

# Uncertainties caused by the new preamble

- **New preamble:** *"without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States"*

- Undisputed that new preamble forms part of **context (**Art. 31(2) VCLT)

- Impact of new preamble mainly considered in relation to the PPT

- However, what is the impact of the new preamble on **other treaty rules,** for example on the beneficial ownership limitation ? See for example OECD Commentaries to art. 10-12: "

*The term "beneficial owner" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries1),* ***rather, it should be understood in its context, in particular in relation to the words "paid … to a resident", and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.***

- **Order of application** of preamble and PPT ? Is the PPT really necessary ?

# The PPT rule as the minimum standard policy response

**Art. 29(9) 2017 OECD MC**

*Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit* ***was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention"***

- Aims at codifying the so-called *"guiding principle"* incorporated in the OECD Commentary in 2003 but is not drafted completely identically
- Is potentially applicable to all distributive rules and to all forms of abuse, notably **abusive restructurings and conduit situations**

# Overview of the PPT rule

➢According to the **2017 OECD Commentary** (para. 173 ad art. 29): *"Paragraph 9 must be read in the context of paragraphs 1 to 7 and of the rest of the Convention, **including its preamble**. This is particularly important for the purposes of determining **the object and purpose of the relevant provisions of the Convention"***

➢In most of the examples of the Commentaries, ***"the object and purpose of the tax convention"*** is referred to in order to determine whether treaty benefits should be granted (Com. para. 182 ad Art. 29, examples A, B, C, D)

•**To deny treaty benefits**, it is contended that "*it would be contrary to the object and purpose of the tax convention to grant the benefit of that exemption under this treaty-shopping arrangement"* (para. 182 ad Art. 29, example A).

•**To grant treaty benefits**, the fact that *"the general objective of tax conventions is to encourage cross-border investment"* is put forward (Com para. 182 ad Art. 29, example C).

➢Compare however with the reasoning followed by the **Canadian Tax Court in Alta** and discussed supra

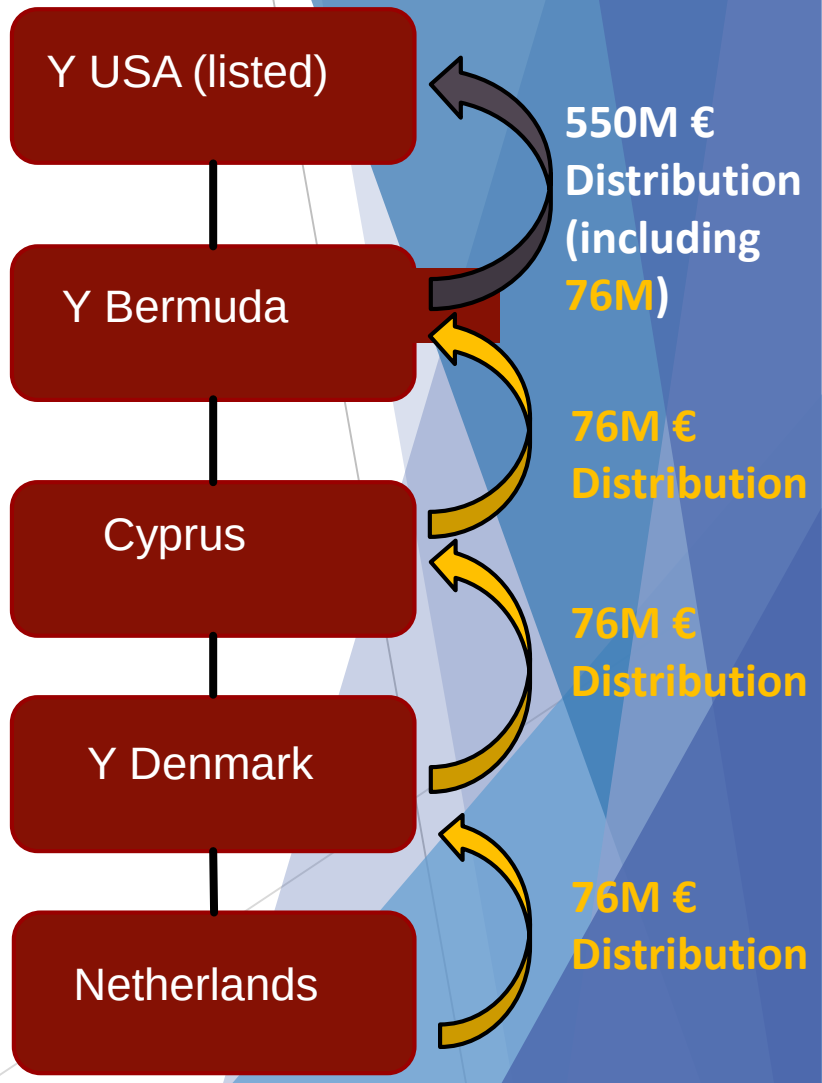
# Areas requiring further clarification

- Enhancement of the ***"nexus safe harbour"*** (OECD Commentary para. N 181 ad art. 29). Further clarifications would be welcome for **IP**, **group finance** and **holding companies**
- Clarification in cases **involving absence of increase of tax treaty benefits**
- Clarification regarding interaction **between PPT and SAARs (including beneficial ownership and BEPS SAARs)**
- Clarification regarding the possibility to **grant alternative tax treaty benefits** even in the absence of a clause corresponding to art. 7(4) MLI (OECD Commentary para. N 184 ad art. 29)
- Interaction with policies on foreign direct investment
- **Interaction with Pillar 2 ?**

# Excursus: Danish Beneficial Ownership Cases (CJEU C-116/16, 26 February 2019)

- *"A group of companies may be regarded as being an artificial arrangement where it is not set up for reasons that reflect economic reality,* ***its structure is purely one of form and its principal objective or one of its principal objectives is to obtain a tax advantage running counter to the aim or purpose of the applicable tax law****. That is so inter alia where, on account of a conduit entity interposed in the structure of the group between the company that pays dividends and the company in the group which is their beneficial owner, payment of tax on the dividends is avoided*". (para. 100)
- *"Likewise, the artificiality of an arrangement is capable of being borne out by the fact that the relevant group of companies* ***is structured in such a way that the company which receives the dividends paid by the debtor company must itself pass those dividends on to a third company (…) with the consequence that it makes only an insignificant taxable profit when it acts as a conduit company in order to enable the flow of funds from the debtor company to the entity which is the beneficial owner of the sums paid.*** *(para. 103)"*

- *«In that regard, when examining the structure of the group it* ***is immaterial that some of the beneficial owners of the dividends paid by the conduit company are resident for tax purposes in a third State which has concluded a double taxation convention with the source Member State. The existence of such a convention cannot in itself rule out an abuse of rights»*** (para. 18)



# Conclusion: the uncertainty remains….

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"*The key question that arises here is how far a multinational group can go when configuring corporate structures to reduce final liability for withholding tax (…) within the Group*"

(Opinion of AG Kokott, Case C–117/16)