Tax avoidance and Treaties

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Tax Treaties and Anti Avoidance

- **Two themes:**
  - Abuse of the tax treaty
    - Treaty Shopping
    - Rule Shopping
  - Application of domestic anti-avoidance rules and tax treaties
    - Relationship domestic general anti-avoidance rule (GAAR) and tax treaty
    - Relationship domestic specific anti-avoidance rule (SAAR) and tax treaty
      - Thin-cap
      - CFC
      - Etc.

BEPS Action 6 – Structure

A. Treaty provisions and/or domestic rules to prevent the granting of treaty benefits in inappropriate circumstances

1. Cases where a person tries to circumvent limitations provided by the treaty itself

a. Treaty shopping

b. Other situations where a person seeks to circumvent treaty limitations

2. Cases where a person try to abuse the provisions of domestic law using treaty benefits

B. Clarification that tax treaties are not intended to be used to generate double non-taxation

C. Tax policy considerations for tax treaties

Improper Use of the Tax Treaty

Treaty “abuse,”… is a heavily loaded term. Not only is it derogatory; it implies that the proper use of a treaty can be identified. Yet differences over precisely that point lie at the heart of the current discussion. Because the term suggests that what is being discussed is a point of common understanding and agreement, when it clearly is not, the usefulness of the term is questionable.

H.D. Rosenbloom, ‘Tax Treaty Abuse: Policy and Issues’, in Law and Policy in International Business, No. 15, 1983, p. 766.

Improper Use of the Tax Treaty

Use that has the sole (predominant) intention to avoid the tax of either or both of the contracting states and that defeats the fundamental and enduring expectations and policy objectives shared by both states and therewith the purpose of the treaty in a broad sense.

Stef van Weeghel, ‘The Improper Use of Tax Treaties’, p. 258.

Improper Use of the Tax Treaty

Prof. Van den Tempel: Such wonderful things can be done with tax treaties.

He meant: treaty shopping

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Treaty Shopping – OECD BEPS Action 6

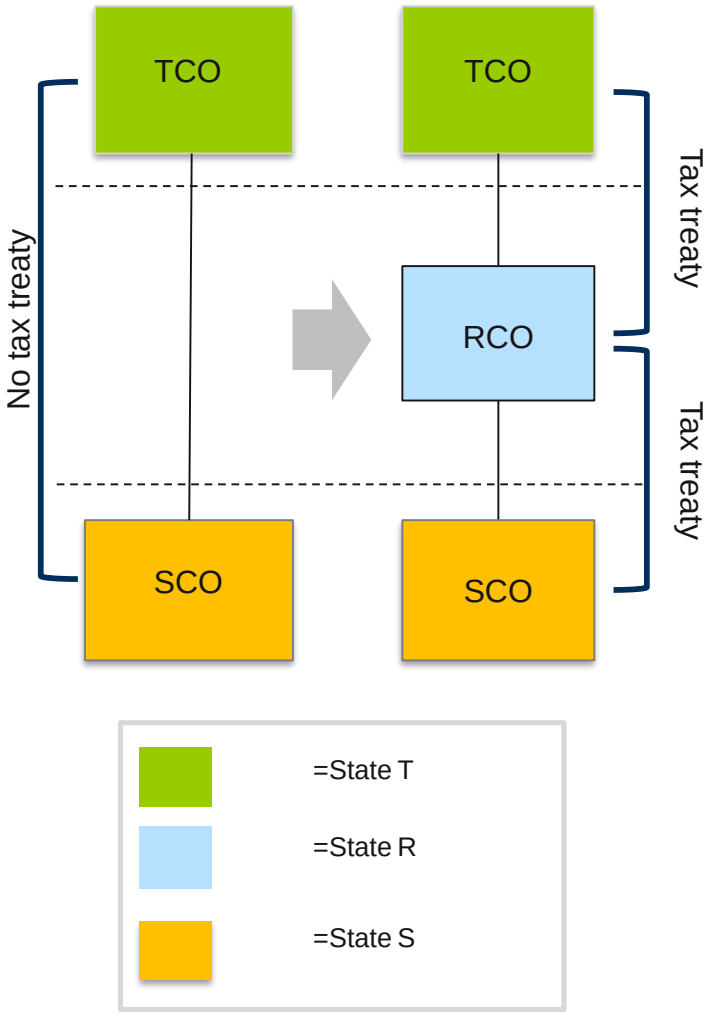
The first requirement that must be met by a person who seeks to obtain benefits under a tax treaty is that the person must be “a resident of a Contracting State”, as defined in Article 4 of the OECD Model Tax Convention. There are a number of arrangements through which a person who is not a resident of a Contracting State may attempt to obtain benefits that a tax treaty grants to a resident of that State. These arrangements are generally referred to as “treaty shopping”.

Treaty Shopping – Commentary on Art. 1 2017 OECD MC

55. The extension of the network of tax conventions increases the risk of abuse by facilitating the use of arrangements aimed at securing the benefits of both the tax advantages available under certain domestic laws and the reliefs from tax provided for in these conventions.

56. 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.

Treaty shopping



- State T does not have a tax convention with State S and therefore any dividend/interest/royalties paid by SCO to TCO is subject to State S withholding tax.
- Under the State R-State S tax treaty there is no/reduced withholding tax on dividends/interest/royalties paid by a company resident of a Contracting State.
- RCO, a resident of State R, is interposed and dividend/interest/royalties are paid by SCO to RCO and then by RCO to TCO.
- 1987 Conduit Company report:
  - Direct Conduit
  - Stepping Stone Conduit

OECD Position – Evolution of the Commentary

- See Commentary, Art. 1, par. 54 et seq., on Improper Use of the Convention
- Note that the Commentary has changed overtime!
- From ‘pacta sunt servanda’ to ‘States do not have to grant the benefits of a double taxation convention where arrangements that constitute an abuse of the provisions of the convention have been entered into.’ (2003 Addition to Comm. Par. 9.4)

The Guiding Principle since 2003

61. It is important to note, however, that it should not be lightly assumed that a taxpayer is entering into the type of abusive transactions referred to above. A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions. That principle applies independently from the provisions of paragraph 9 of Article 29, which merely confirm it.

What is wrong with treaty shopping?

- Reciprocity is broken
- Treaty may become a device to avoid all taxation
- Negotiating position of source country deteriorates

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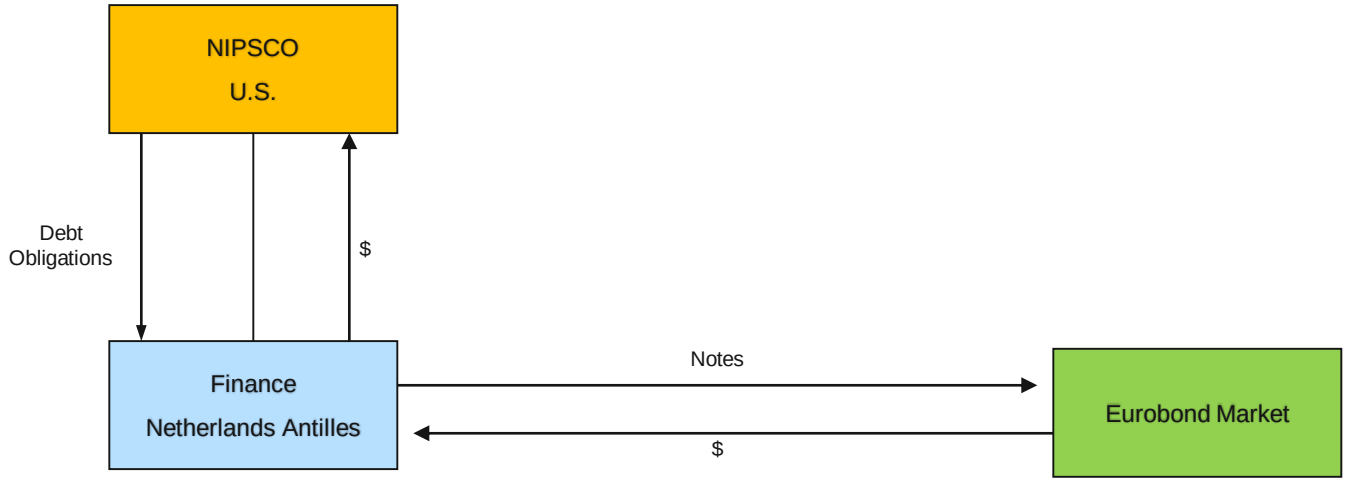
Remedies?

- Sham/Substance-over form/Fraus legis/Abuse of law/GAAR
  - Aiken Industries
  - Northern Indiana Public Service Company
  - BNB 1994/253
  - MIL (Investments) SA v Canada
  - A Holding ApS v Federal Tax Administration
  - Yanko Weiss Holdings (1996) Ltd. V Holon Assessing Office
  - Various cases by Dutch Hoge Raad
  - Azadi Bachao Andolan
  - Alta Energy
  - Etc.etc.
- Beneficial Ownership in post ’77 treaties
- Principle Purpose Test (PPT), Limitation on benefits (LOB)

Relationship domestic general anti-avoidance rule (GAAR) and tax treaty

- See Commentary on Improper Use, par. 54-80
- How tax avoidance is dealt with:
  - Sham, simulation, substance over form
  - Characterization, possibly for tax purposes only (example: a loan is characterized as equity)
  - Extensive interpretation
  - Fraus legis/Abuse of Law/GAAR
    - Actions
    - Contrary to object and purpose of the law
    - Tax avoidance as motive

Northern Indiana Public Service Company v. Commissioner (1995/1997)



Facts

- Finance issued notes in the Eurobond market and lent the proceeds to NIPSCO at a small profit. NIPSCO guaranteed the Euronotes

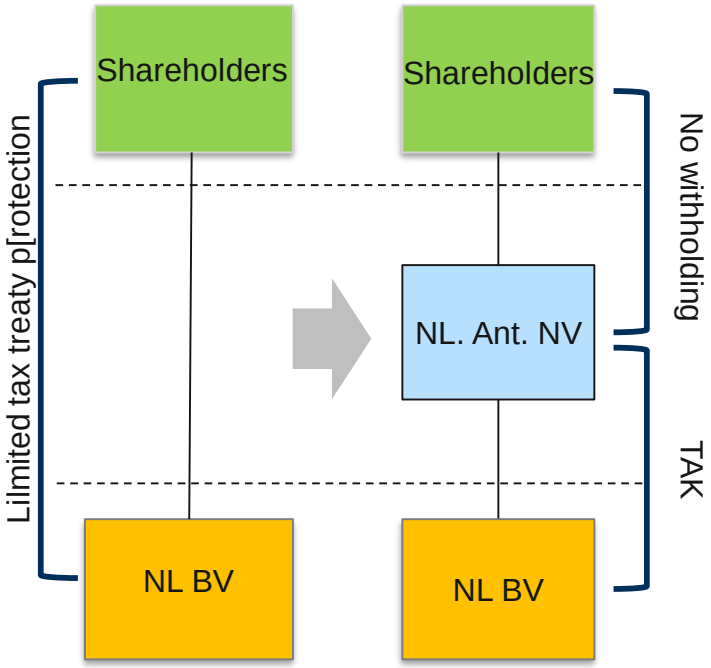
Northern Indiana Public Service Company v. Commissioner

- Applicable Tax Treaty – No withholding on interest payments by a U.S. corporation to a Netherlands Antilles corporation

- Issue – should the interest on the Eurobonds be treated as paid directly by NIPSCO U.S.?

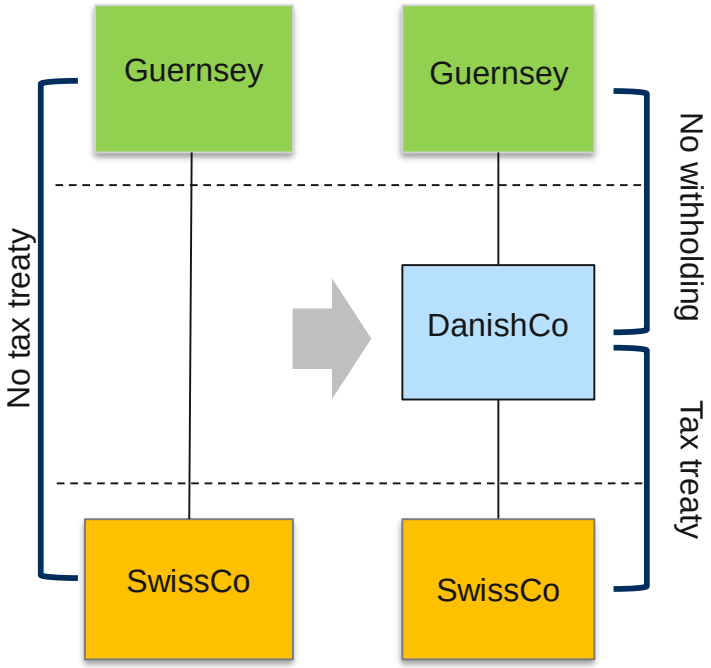
- Holding – Distinguishable from Aiken, because Finance's borrowing and lending activity was a business activity that resulted in significant earnings for Finance. Petitioner was required to pay interest at 18-1/4 percent, whereas Finance issued the Euronotes at 17-1/4 percent. Finance's aggregate income on the spread between the Euronote interest and the interest on petitioner's note was $2,800,000. In addition, Finance earned interest income on its investments (exclusive of interest received from petitioner) during its existence.

Hoge Raad, 18 May 1994, BNB 1994/253



- Imposition of Netherlands Antilles company between Netherlands BV and its shareholders
- Supreme Court held:
  - The mere circumstance that the shares in [BV] have been contributed and sold, as the case may be, to [Netherlands Antilles NV] solely for tax reasons, does not lead to the conclusion that there is a dealing in contravention of the object and purpose of the [TAK] and the [DTA].
  - The circumstances … that [NV] is a company incorporated in a country with a low tax burden, [that NV] does not perform economic activity … and [that NV] is solely based on incorporation in the country with the low tax burden by fiction of law a resident there, are insufficient reasons to decide differently.

A Holding ApS (2005)



- Imposition of Danish company between Swiss company and its Guernsey shareholder.
- Dividend from SwissCo to DanishCo
- Swiss Federal Court held:
  - Danish company did not prove that it had an active trade or business
  - There was an abusive use of the treaty
  - Domestic rules against abuse were applicable

More cases

- Yanko Weiss Holdings (1996) Ltd. V Holon Assessing Office
- Various cases by Dutch Hoge Raad
- Lone Star
- Azadi Bachao Andolan
- Alta Energy
- etc.

Azadi Bachao Andolan (India, 2003)

There are many principles in fiscal economy which, though at first blush might appear to be evil, are tolerated in a developing economy, in the interest of long-term development. Deficit financing, for example, is one; treaty shopping, in our view, is another. Despite the sound and fury of the respondents over the so-called "abuse" of "treaty shopping", perhaps, it may have been intended at the time when the Indo-Mauritius DTAC was entered into. Whether it should continue, and, if so, for how long, is a matter which is best left to the discretion of the executive as it is dependent upon several economic and political considerations. This court cannot judge the legality of treaty shopping merely because one section of thought considers it improper.

Alta Energy (Canada, 2018)

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.

Beneficial Ownership

- Commentary on Article 1, par. 63: “[S]ome forms of tax avoidance have already been expressly dealt with in the Convention, e.g. by the introduction of the concept of “beneficial owner” (in Articles 10, 11, and 12).”
- The purpose is to limit – under certain circumstances – the benefits that are otherwise available under a tax treaty
- Application is basically relevant for dividends, interest and royalties
- What is the issue? Historically, art. 10, 11 and 12 applied if income from source state was *received* by a resident of the other state

Article 11 OECD Model Convention 1963

Interest

1. Interest arising in a Contracting State and *paid to* a resident of the other Contracting State may be taxed in that other State.
2. However, such interest may be taxed in the Contracting State in which it arises, and according to the law of that State, but the tax so charged shall not exceed 10 per cent of the amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

Commentary to Article 11 OECD Model Convention

5. Paragraph 1 lays down the principle that interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in the latter. In doing so, it does not stipulate an exclusive right to tax in favour of the State of residence. The term “paid” has a very wide meaning, since the concept of payment means the fulfilment of the obligation to put funds at the disposal of the creditor in the manner required by contract or by custom.

When are benefits available

Thus, benefits of Articles 10, 11 and 12 are available if:

i) there is a resident

ii) income is paid to such resident

Cf. MacMillan Bloedel

MacMillan Bloedel Ltd. v. Minister of National Revenue

- MacMillan Bloedel paid interest in respect of 'series C debentures' to Paine Webber and to a 'streetname' (Bank of New York)
- Article XI(1) of the 1942 US-Canada treaty read as follows:
  - The rate of income tax imposed by one of the contracting States, in respect of income (other than earned income) derived from sources therein, upon individuals in, or corporations organized under the laws of, the other contracting State, and not having a permanent establishment in the former State, shall not exceed fifteen per cent for each taxable year.
- Information Circular 76-12 required 'beneficial ownership'

MacMillan Bloedel Ltd. v. Minister of National Revenue

The Tax Review Board held:

- Paine Webber and Bank of New York are ‘corporations organized under the laws of [the United States]’

- The view of the Department of National Revenue ‘can be upheld only if words are added to the [national law and the treaty] so that is clearly indicated that the reduced rate of tax is not given to the registered owner, but only to the registered owner if he establishes that the beneficial owner (…) of the interest would be entitled to the reduction if the debenture were registered in his name’

Beneficial Ownership since 1977

Article 11

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, interest arising in a Contracting State may also be taxed in that State according to the laws of that State, *but if the beneficial owner of the interest* is a resident of the other Contracting State, the tax so charged shall not exceed 10 percent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

Commentary on Article 1 (Personal Scope)

- 54. 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. As confirmed in the preamble of the Convention, it is also a part of the purposes of tax conventions to prevent tax avoidance and evasion..
- 56. This [risk of abuse] 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.
- 63. For instance, some forms of tax avoidance have already been expressly dealt with in the Convention, e.g. by the introduction of the concept of "beneficial owner" (in Articles 10, 11 and 12) …

OECD Conduit Companies Report 1987

"The OECD has incorporated in its revised 1977 Model provisions precluding in certain cases persons not entitled to a treaty from obtaining its benefits through a 'conduit company'. Thus the limitation is not available when, economically, it would benefit a person not entitled to it who interposed the conduit company as an intermediary between himself and the payer of the income… The Commentaries mention the case of a nominee or agent. The provisions would, however, apply also to other cases where a person enters into contracts or takes over obligations *under which he has similar function to those of a nominee or agent*."

OECD Conduit Companies Report

“Thus a conduit company can normally not be regarded as the beneficial owner if, though the formal owner of certain assets, it has very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties (most likely the shareholders of the conduit company)."

Commentary to Articles 10, 11 and 12 from 1977 - 2014

- (1977) 12. Under paragraph 2, the limitation of tax in the State of source is not available when an intermediary, such as an agent or nominee, is interposed between the beneficiary and the payer, unless the beneficial owner is a resident of the other Contracting State. States which wish to make this more explicit are free to do so during bilateral negotiations.
- Various incarnations between 1977 and 2014.
- Various discussion drafts addressing the meaning of ‘beneficial ownership’.
- Finally, in the 2014 update to the Commentary, the text with respect to ‘beneficial ownership’ was revised.

Commentary to Articles 10, 11 and 12 since 2014 update

12. The requirement of beneficial ownership was introduced in paragraph 2 of Article 10 to clarify the meaning of the words "paid ... to a resident" as they are used in paragraph 1 of the Article. It makes plain that the State of source is not obliged to give up taxing rights over dividend income merely because that income was paid direct to a resident of a State with which the State of source had concluded a convention.

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Commentary to Articles 10, 11 and 12 since 2014 update

12.1 Since the term “beneficial owner” was added to address potential difficulties arising from the use of the words “paid to … a resident” in paragraph 1, it was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries). 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 countries [5]), 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.

Commentary to Articles 10, 11 and 12 since 2014 update

12.2 Where an item of income is paid to a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence.

Commentary to Articles 10, 11 and 12 since 2014 update

12.3 It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies“ concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.

Commentary to Articles 10, 11 and 12 since 2014 update

12.4 In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the dividend is not the “beneficial owner” because that recipient’s right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person.

Commentary to Articles 10, 11 and 12 since 2014 update

This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the payment by the direct recipient such as an obligation that is not dependent on the receipt of the payment and which the direct recipient has as a debtor or as a party to financial transactions, or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 6.8 to 6.34 of the Commentary on Article 1.

Commentary to Articles 10, 11 and 12 since 2014 update

Where the recipient of a dividend does have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the “beneficial owner” of that dividend. It should also be noted that Article 10 refers to the beneficial owner of a dividend as opposed to the owner of the shares, which may be different in some cases.

Commentary to Articles 10, 11 and 12 since 2014 update

12.5 The fact that the recipient of a dividend is considered to be the beneficial owner of that dividend does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraphs 17 and 22 below). As explained in the section on “Improper use of the Convention” in the Commentary on Article 1, there are many ways of addressing conduit company and, more generally, treaty shopping situations.

Commentary to Articles 10, 11 and 12 since 2014 update

These include specific anti-abuse provisions in treaties, general anti-abuse rules and substance-over-form or economic substance approaches. Whilst the concept of “beneficial owner” deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the dividend to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

Commentary to Articles 10, 11 and 12 since 2014 update

12.6 The above explanations concerning the meaning of “beneficial owner” make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments [7] that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of “beneficial owner” cannot be applied in the context of the Article. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 a), which refers to the situation where a company is the beneficial owner of a dividend.

Commentary to Articles 10, 11 and 12 since 2014 update

In the context of Article 10, the term “beneficial owner” is intended to address difficulties arising from the use of the words “paid to” in relation to dividends rather than difficulties related to the ownership of the shares of the company paying these dividends. For that reason, it would be inappropriate, in the context of that Article, to consider a meaning developed in order to refer to the individuals who exercise “ultimate effective control over a legal person or arrangement.”

Commentary to Articles 10, 11 and 12 since 2014 update

12.7 Subject to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 and in 2014 to clarify this point, which has been the consistent position of all member countries).

NB This is an important difference with the 'discretionary relief' provision in LOB.

Interpretation of the term beneficial owner

- The term is not defined in the treaty
- Thus, recourse must be had to Article 3(2), i.e.
  - Domestic law
  - Unless the context otherwise requires
- Contextual interpretation?
- International tax meaning?
- Treaty definition
- Case law

Domestic law - Dutch Underminister of Finance

- The use of this term has its purpose to lay down in tax treaties the intention of the contracting parties that application of certain treaty provisions is not always warranted based on apparent circumstances, but that these provisions are only applicable if the taxpayer is the ultimate, i.e. the real, beneficiary of the income.
- Back-to-back structures do not result in entitlement to treaty application. In that light it is not necessary to provide for a more precise description of the term ‘beneficial ownership’. Incidentally, in such cases, the factual circumstances of each individual case are of crucial importance, which makes it difficult to provide for more precise description.

Domestic law - Dutch Underminister of Finance

- The meaning of the term ‘beneficial owner’ in international tax law is strongly determined by factual circumstances. It is therefore not possible to give further meaning to this term in a general manner. Recommendations in this area are therefore completely lacking in the OECD Model Convention.

- The Netherlands takes the viewpoint that a person cannot be considered the beneficial owner if he is, for example, contractually obliged to pay the largest part of the income to third parties.

Domestic law - United States Final Conduit Financing Regulations

"[The] IRS and Treasury believe that these regulations supplement, but do not conflict with, the limitation on benefits articles in tax treaties. They do so by determining which person is the beneficial owner of income with respect to a particular financing arrangement. Because the financing entity is the beneficial owner of the income, it is entitled to claim the benefits of any income tax treaty to which it is entitled to reduce the amount of tax imposed by section 881 on that income. The conduit entity, as an agent of the financing entity, cannot claim the benefits of a treaty to reduce the amount of tax due under section 881 with respect to payments made pursuant to the financing arrangement."

Technical Explanation of the 1996/2006 United States Model Convention

- The "beneficial owner" of a royalty payment is understood generally to refer to any person resident in a Contracting State to whom that State attributes the payment for purposes of its tax. (…). Further, in accordance with paragraph 4 of the OECD Commentaries to Article 12, the source State may disregard as beneficial owner certain persons that nominally may receive a royalty payment but in substance do not control it. See also, paragraph 24 of the OECD Commentaries to Article 1 (General scope). (1996)
- The term “beneficial owner” is not defined in the Convention, and, is therefore, defined under the internal law of the State of source. The beneficial owner of the royalty for the purposes of Article 12 is the person to which the income is attributable under the laws of the source State. (2006)

Case law – Beneficial Ownership

- Dutch Hoge Raad BNB 1994/217
- Indofood
- Prévost/ Velcro
- Bank of Scotland
- PT Transportasi Indonesia
- Swaps case
- Danish cases
- Etc. etc.

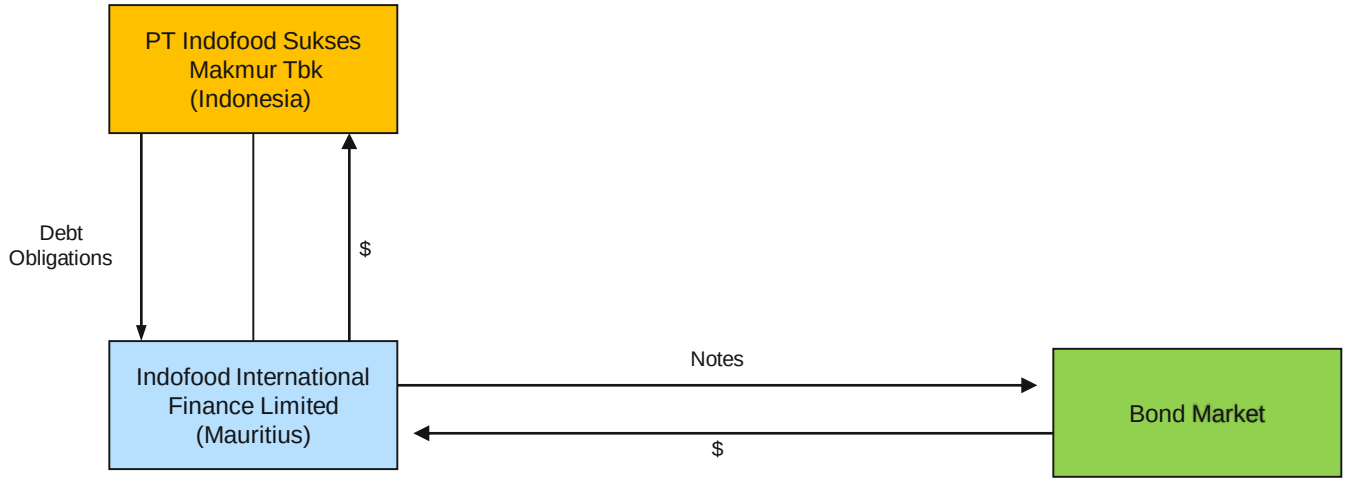
Dutch Hoge Raad, in BNB 1994/217

The taxpayer became the owner of the dividend coupons as a result of purchase thereof. It can further be assumed that subsequent to the purchase the taxpayer could freely avail of those coupons, and subsequent to the cashing thereof could freely avail of the distribution. And in cashing the coupons the taxpayer did not act as voluntary agent (zaakwaarnemer) or for the account of the principal (lasthebber). Under those circumstances the taxpayer is the beneficial owner of the dividend.

Dutch Hoge Raad, in BNB 1994/217

The tax treaty does not contain the condition that the beneficial owner of the dividend must also be the owner of the shares and further it is irrelevant that the taxpayer purchased the coupons at the time the dividend had already been announced, because the question who is the owner must not be answered at the time the dividend is announced, but at the time the dividend is made payable.

Indofood, Court of Appeal of England and Wales (2006)



Facts

- Indofood issued notes in the Eurobond market and lent the proceeds to its parent at a small profit. Indofood guaranteed the Euronotes

Indofood

- Holding:
  - Finance (Newco) would not have the “full privilege” needed to qualify as the beneficial owner.
  - Rather, the position of the issuer and Newco equated to that of “administrator of the income”.

LOB/PPT - BEPS Action 6

A. Treaty provisions and/or domestic rules to prevent the granting of treaty benefits in inappropriate circumstances

1. Cases where a person tries to circumvent limitations provided by the treaty itself

a.Treaty shopping

b. Other situations where a person seeks to circumvent treaty limitations

2. Cases where a person try to abuse the provisions of domestic law using treaty benefits

B. Clarification that tax treaties are not intended to be used to generate double non-taxation

C. Tax policy considerations for tax treaties

Action 6 - Treaty Shopping Minimum Standard

- An express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.
- Countries will implement this common intention by including in their treaties:

  (i) the combined approach of an LOB and PPT rule

  (ii) the PPT rule alone, or

  (iii) the LOB rule supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties.

Minimum standard as expressed in the Commentary

The drafting of this Article will depend on how the Contracting States decide to implement their common intention, reflected in the preamble of the Convention and incorporated in the minimum standard agreed to as part of the OECD/G20 Base Erosion and Profit Shifting Project, to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty-shopping arrangements. This may be done either through the adoption of paragraph 9 only, through the adoption of the detailed version of paragraphs 1 to 7 that is described in the Commentary on Article 29 together with the implementation of an anticonduit mechanism as described in paragraph 187 of that Commentary, or through the adoption of paragraph 9 together with any variation of paragraphs 1 to 7 described in the Commentary on Article 29.

2017 OECD MC PREAMBLE TO THE CONVENTION

(State A) and (State B),

Desiring to further develop their economic relationship and to enhance their cooperation in tax matters,

Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital 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),

Have agreed as follows:

ARTICLE 29 2017 OECD MC: ENTITLEMENT TO BENEFITS

- Basic structure of the Limitation on Benefits (LOB) provision can be found in Article 29(1)-(7)
- The simplified and detailed LOB provisions can be found in the Commentary on Article 29(1)-(7)
- Article 29(8) covers triangular PE situations
- Article 29(9) contains the Principal Purposes Test (PPT)

Article 29(1) OECD MC

MC: 1. [Provision that, subject to paragraphs 3 to 5, restricts treaty benefits to a resident of a Contracting State who is a “qualified person” as defined in paragraph 2].

Commentary: Simplified and detailed versions

1. Except as otherwise provided in this Article, a resident of a Contracting State shall not be entitled to a benefit that would otherwise be accorded by this Convention (other than a benefit under paragraph 3 of Article 4, paragraph 2 of Article 9 or Article 25) unless such resident is a “qualified person”, as defined in paragraph 2, at the time that the benefit would be accorded.

Article 29(2) OECD MC

[Definition of situations where a resident is a qualified person, which covers

- an individual;
- a Contracting State, its political subdivisions and their agencies and
- instrumentalities;
- certain publicly-traded companies and entities;
- certain affiliates of publicly-listed companies and entities;
- certain non-profit organisations and recognised pension funds;
- other entities that meet certain ownership and base erosion requirements;
- certain collective investment vehicles.]

Article 29(3-7) OECD MC

3. [Provision that provides treaty benefits to certain income derived by a person that is not a qualified person if the person is engaged in the active conduct of a business in its State of residence and the income emanates from, or is incidental to, that business].

4. [Provision that provides treaty benefits to a person that is not a qualified person if at least more than an agreed proportion of that entity is owned by certain persons entitled to equivalent benefits].

5. [Provision that provides treaty benefits to a person that qualifies as a "headquarters company"].

6. [Provision that allows the competent authority of a Contracting State to grant certain treaty benefits to a person where benefits would otherwise be denied under paragraph 1].

7. [Definitions applicable for the purposes of paragraphs 1 to 7].

Article 29(8) OECD MC

(a) Where

(i) an enterprise of a Contracting State derives income from the other Contracting State and the first-mentioned State treats such income as attributable to a permanent establishment of the enterprise situated in a third jurisdiction, and

(ii) the profits attributable to that permanent establishment are exempt from tax in the first-mentioned State,

the benefits of this Convention shall not apply to any item of income on which the tax in the third jurisdiction is less than the lower of [rate to be determined bilaterally] of the amount of that item of income and 60 per cent of the tax that would be imposed in the first-mentioned State on that item of income if that permanent establishment were situated in the first-mentioned State. In such a case any income to which the provisions of this paragraph apply shall remain taxable according to the domestic law of the other State, notwithstanding any other provisions of the Convention.

Article 29(8) OECD MC

(b) The preceding provisions of this paragraph shall not apply if the income derived from the other State emanates from, or is incidental to, the active conduct of a business carried on through the permanent establishment (other than the business of making, managing or simply holding investments for the enterprise's own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance enterprise or registered securities dealer, respectively).

Article 29(8) OECD MC

(c) If benefits under this Convention are denied pursuant to the preceding provisions of this paragraph with respect to an item of income derived by a resident of a Contracting State, the competent authority of the other Contracting State may, nevertheless, grant these benefits with respect to that item of income if, in response to a request by such resident, such competent authority determines that granting such benefits is justified in light of the reasons such resident did not satisfy the requirements of this paragraph (such as the existence of losses). The competent authority of the Contracting State to which a request has been made under the preceding sentence shall consult with the competent authority of the other Contracting State before either granting or denying the request

Article 29(9) OECD MC

9. 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.

Commentary Art. 29(9) OECD MC

169. Paragraph 9 mirrors the guidance in paragraphs 61 and 76 to 80 of the Commentary on Article 1. According to that guidance, the benefits of a tax convention should not be available where one of the principal purposes of certain transactions or arrangements is to secure a benefit under a tax treaty and obtaining that benefit in these circumstances would be contrary to the object and purpose of the relevant provisions of the tax convention. Paragraph 9 incorporates the principles underlying these paragraphs into the Convention itself in order to allow States to address cases of improper use of the Convention even if their domestic law does not allow them to do so in accordance with paragraphs 76 to 80 of the Commentary on Article 1; it also confirms the application of these principles for States whose domestic law already allows them to address such cases.

Note: Art. 29(9) effectively reverses ‘the burden of proof’

Treaty interpretation - Art. 31 VCLT

Article 31, GENERAL RULE OF INTERPRETATION

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) Any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;

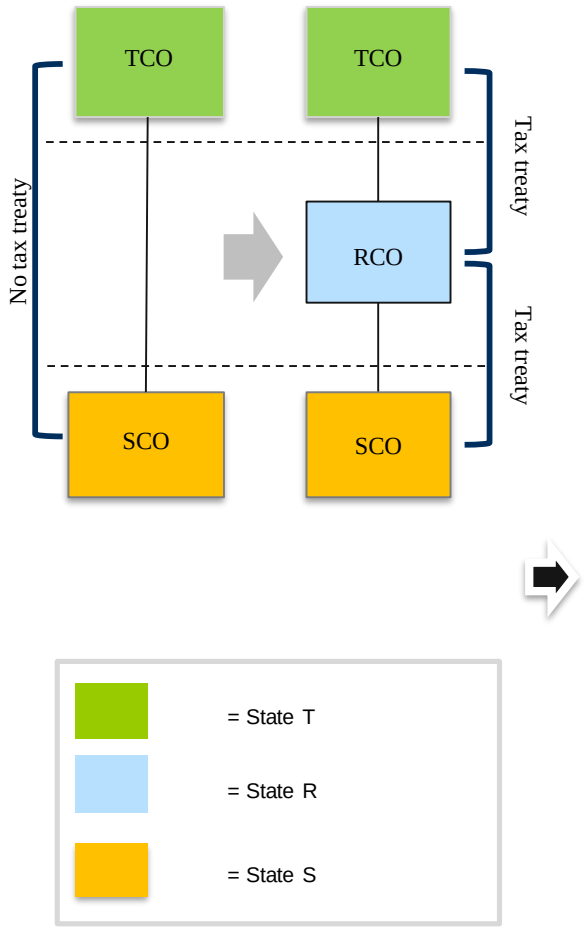
(b) Any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

Commentary Art. 29(9) OECD MC

171. Paragraph 9 supplements and does not restrict in any way the scope or application of the provisions of paragraphs 1 to 7 (the limitation-on-benefits rule) and of paragraph 8 (the rule applicable to a permanent establishment situated in a third jurisdiction): a benefit that is denied in accordance with these paragraphs is not a "benefit under the Convention" that paragraph 9 would also deny. Moreover, the guidance provided in the Commentary on paragraph 9 should not be used to interpret paragraphs 1 to 8 and vice-versa.

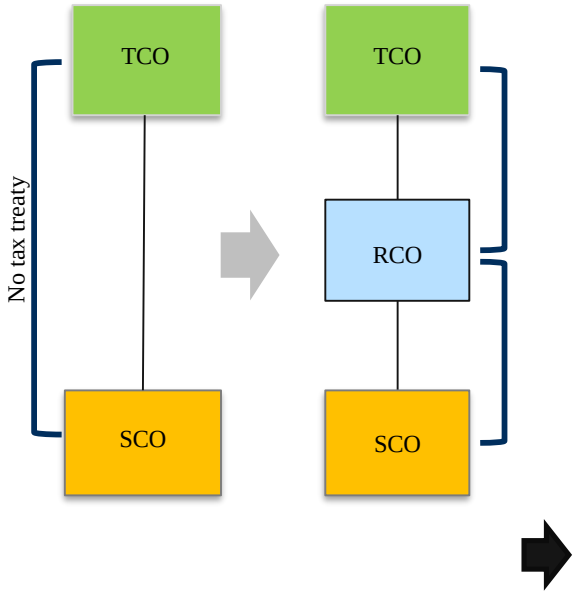
172. Conversely, the fact that a person is entitled to benefits under paragraphs 1 to 7 does not mean that these benefits cannot be denied under paragraph 9. Paragraphs 1 to 7 are rules that focus primarily on the legal nature, ownership in, and general activities of, residents of a Contracting State. As illustrated by the example in the next paragraph, these rules do not imply that a transaction or arrangement entered into by such a resident cannot constitute an improper use of a treaty provision.

Example A: Base case



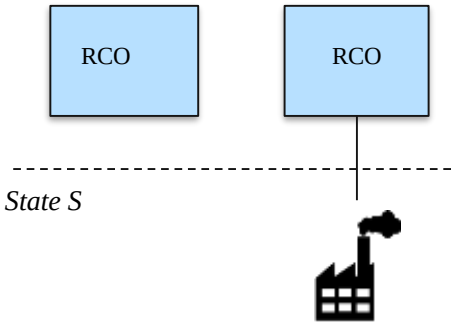
- State T does not have a tax convention with State S and therefore any dividend paid by the SCO to TCO is subject to withholding taxon dividends of 25 per cent.
- Under the State R-State S tax convention there is no withholding tax on dividends paid by a company resident of a Contracting State.
- TCO enters into an agreement with RCO, an independent resident of State R pursuant to which TCO assigns to RCO the right to the payment of dividends.
- One of the *principal purposes* for the arrangement was to obtain the benefit of the exemption from source taxation of dividends.

Example B: Usufruct newly issued non-voting pref's



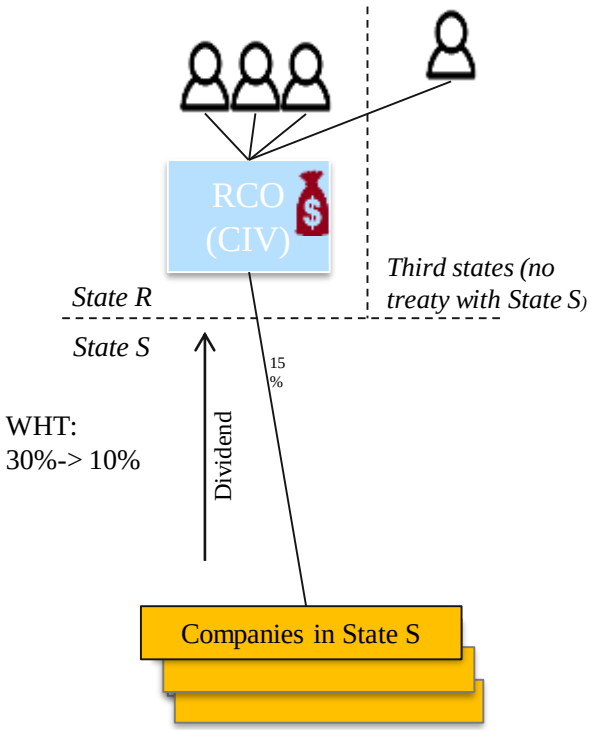
- State T does not have a tax convention with State S and therefore any dividend paid by the SCO to TCO is subject to withholding taxon dividends of 25%.
- Under the State R-State S tax convention there is 5% withholding tax on dividends paid by a company resident of a Contracting State.
- TCO enters into an agreement with RCO (bank).
- Rco acquires usufruct of newly issued non-voting preferred shares of SCO; gives RCO the right to receive the dividends
- Value equal to present value dividend over next 3 years.
- one of the *principal purposes* for the arrangement was to obtain the benefit of the limitation of 5% taxation

Example C: manufacturing plant in dev. country



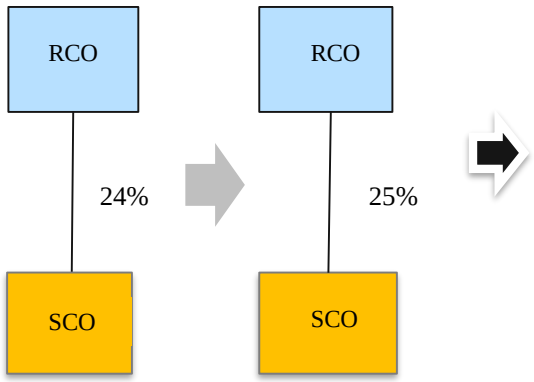
- RCO is in the business of producing electronic devices and its business is expanding rapidly.
- RCO is considering establishing a manufacturing plant in a developing country in order to benefit from lower costs.
- After a preliminary review, possible locations in three different countries are identified. All three countries provide similar economic and political environments.
- RCO chooses State S because this is the only state which State R has a tax convention with.
- The *principal purposes* are clearly related to the expansion of RCO's business and the lower manufacturing costs of that county, *not* obtaining the treaty benefit.
- *The OESO stated:*
  'In addition, given that a general objective of tax conventions is to encourage cross-border investment, obtaining the benefits of the State R-State S convention for the investment in the plant built in State S is in accordance with the object and purpose of the provisions of that convention."

Example D: collective investment fund



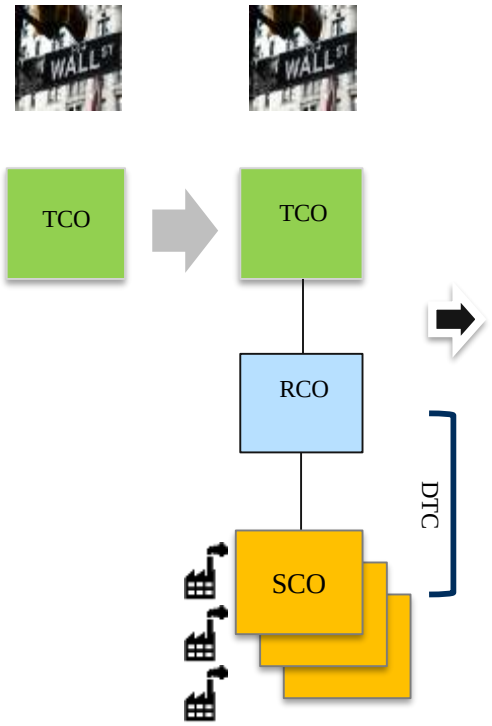
- RCO is a collective investment vehicle, manages a diversified portfolio of investments. 15% of his portfolio in shares in companies in State S. RCO's investment decisions take into account the existence of tax benefits provided under State R's extensive tax convention network.
- A majority of investors are residents of State R but a number of investors are residents of non-convention States.
- Under tax convention between State R and State S the withholding tax dividends is reduced from 30% to 10%.
- Investors' decisions to invest in RCO are not driven by any particular investment made by RCO, and RCO's investment strategy is not driven by the tax position of its investors. RCO annually distributes almost all of its income to its investors and pays taxes in State R on income not distributed during the year.
- RCO considered the existence of a benefit under the convention but this alone would *not* mean that this was the *principal purpose*.
- Unless RCO's investment is part of an arrangement or relates to another transaction undertaken for a principal purpose of obtaining the benefit, it would not be reasonable to deny the benefit.

Example E: increase stake to benefit from DTC



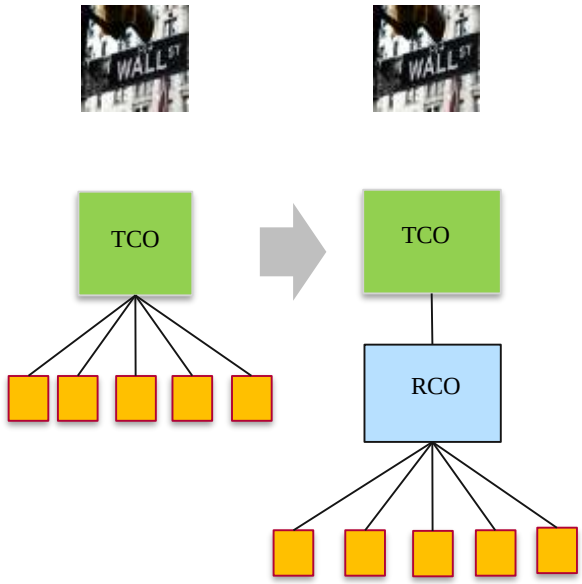
- RCO has held 24% of the shares of SCO the last 5 years.
- RCO decides to increase its ownership to 25%. This decision has been made primarily in order to obtain the benefit of the lower tax rate provided by the convention.
- although one of the *principal purposes* for the transaction is to obtain the benefit of the convention, paragraph 9 would not apply because it may be established that granting that benefit in these circumstances would be in accordance with the object and purpose of Article 10(2) a).
- The threshold of 25% is arbitrary and shareholders are entitled to increase their participation in order to satisfy this requirement.

Example F: acquisition of holding company



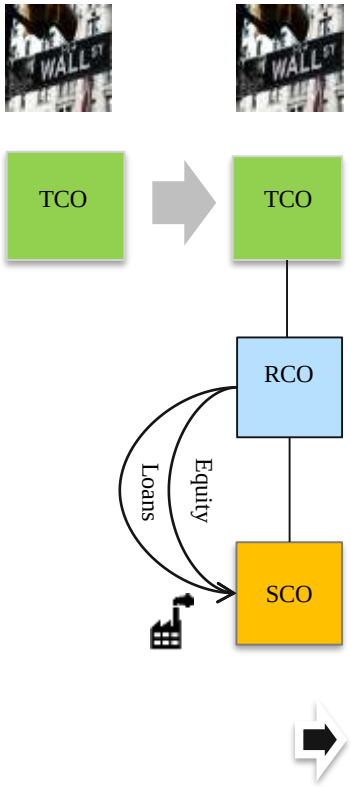
- TCO (publicly traded company) has an information technology business which has grown as a result of aggressive merger policy.
- RCO is an holding company in the same sector.
- Between States R and S exists a favourable convention.
- the *principal purpose* for the acquisition of RCO isrelated to the expansion of the business of the TCO group and do *not* include the obtaining of benefits under the treaty between States R and S.
- The fact that's RCO acts as a holding company does not change that.
- Regardless of the fact that TCO's management will consider the benefits of the treaty between States R and S afterwards.

Example G: Creating a regional hub



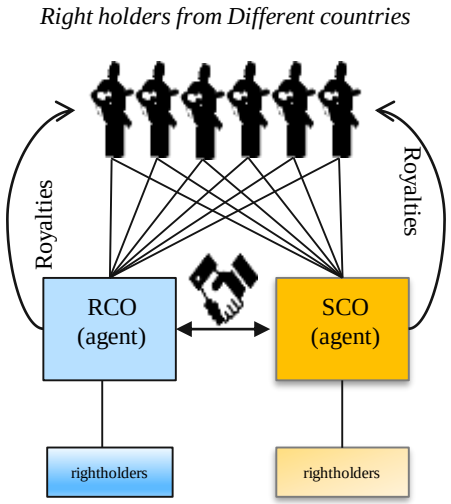
- TCO is a publicly traded company and owns a number of subsidiaries in neighbouring countries.
- Establishment of the regional company RCO for the purpose of providing services including accounting, legal advice etc.
- The establishment in country R is driven by the skilled labour force, reliable legal system, business friendly environment, political stability and the treaty network.
- Merely reviewing the effects of the treaties would *not* enable the conclusion that this was the *main purpose* of establishment of RCO. This because its constitute a real business with substantive economic functions.

Example H: Hold/finco for foreign activities



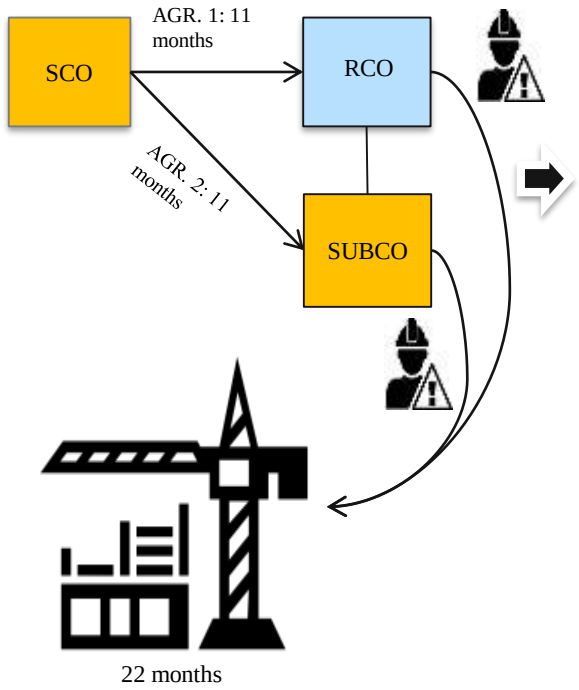
- TCO is the listed parent company of a multinational enterprise that conducts a variety of business activities.
- Issues related to transportation, time differences, limited availability of personnel fluent in foreign languages and the foreign location of business partners make it difficult for TCO to manage its foreign activities from State T.
- TCO therefore establishes RCO, a subsidiary resident of State R (a country where there are developed international trade and financial markets as well as an abundance of highly-qualified human resources), as a base for developing its foreign business activities.
- As part of its activities, RCO also undertakes the development of new manufacturing facilities in State S. For that purpose, it contributes equity capital and makes loans to SCO, a subsidiary resident of State S that RCO established for the purposes of owning these facilities. RCO will receive dividends and interest from SCO.
- RCO has been established for business efficiency reasons and constitute an active conduct of business.
- *principal purpose* is *not* the obtaining of benefits of the treaty between States R and S.

Example I: copyright agents



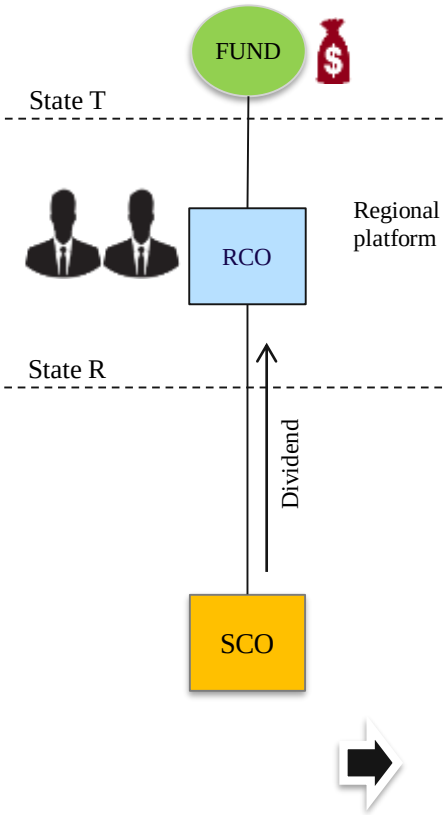
- RCO and SCO grant licences on behalf of right- and copyright holders for playing music etc. and receive royalties which they distribute to each right holder.
- RCO and SCO have an agreement with each other that the one party grant licenses and distributes royalties of the other party with respect to the rights that the other party manages.
- SCO has agreed with the tax administration that it will process the royalty withholding tax on the payments to RCO, based on the applicable treaties between States S and the State of residence of each right holder.
- Arrangements have been put in place for efficient management of the granting of licenses and collection of royalties.
- the *purpose* is to ensure that withholding tax is collected at the correct rate without the need for each holder to apply for a refund on small payments; *not* to obtain benefit of the treaty .

Example J: avoidance of construction PE



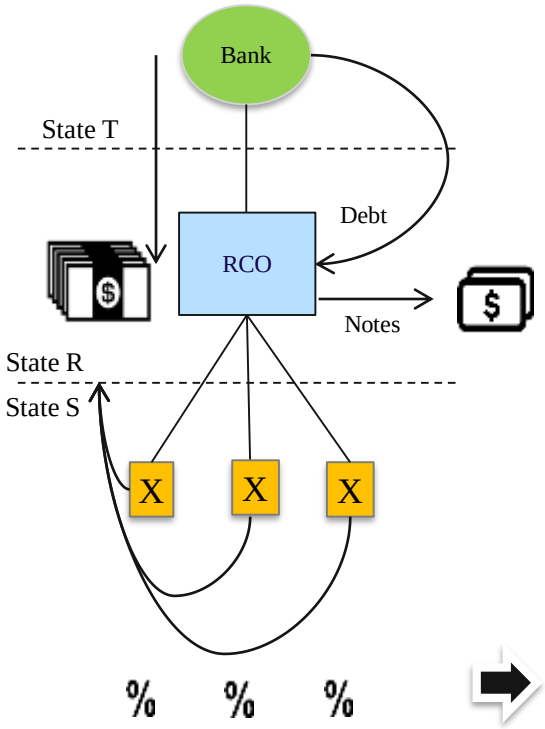
- Construction project power plant is expected to last 22 months; divided in two contracts, each lasting 11 month
- RCO is contractually jointly and severally liable for the performance of the two contracts (incl. SUBCO).
- the separate contract with SUBCO is part of a construction to each (RCO and SUBCO) obtain the benefit of the rule of art.5-3 (permanent establishment); *contrary* to the *purpose*.
- Art. 14 MLI

Example K: fund/institutional investor



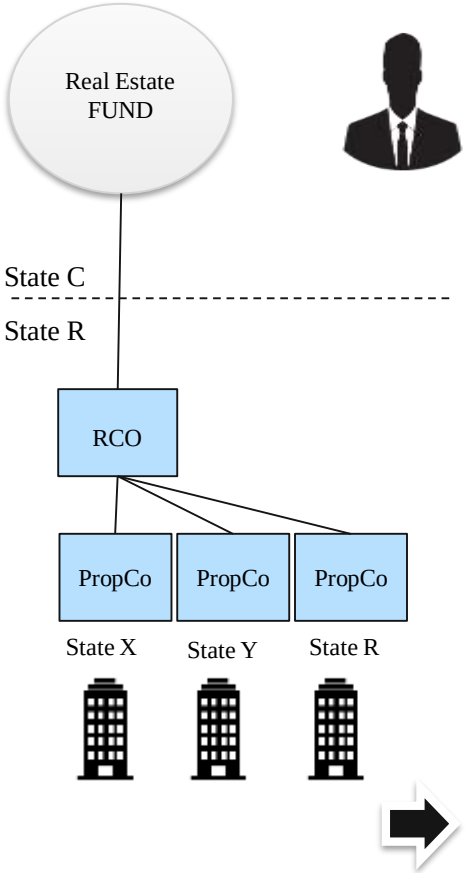
- Fund is resident of State T. RCO operates as the regional investment platform trough acquisition and management of a diversified portfolio.
- The decision to establish the regional investment platform in State R was mainly driven by the availability of directors with knowledge of regional business practices and regulations, the existence of a skilled multilingual workforce, State R's membership of a regional grouping and the extensive tax convention network of State R, including its tax convention with State S, which provides for low withholding tax rates.
- RCO employs an experienced local management team to review investment recommendations from Fund and performs various other functions. The board of directors of RCO is appointed by Fund and is composed of a majority of State R resident directors.
- RCO invests in SCO, only part of RCO's overall investment portfolio which includes investments in a number of countries in addition to State S which are also members of the same regional grouping.
- Under the tax convention between State S and R the tax rate is reduced to 5%, under S and T its reduced to 10%.
- whether or not to invest in SCO, RCO considers the existence of a benefit under the tax convention between State R and S. However the investment is not part of an arrangement for a *principal purpose* of obtaining the benefit of the convention; *not* reasonable to deny the benefit.

Example L: securitisation arrangement



- Bank is resident in State T. RCO is fully debt-funded. RCO has issued a single share which his held on trust and has no economic value.
- RCO holds 60% of its portfolio in receivables of enterprises in State S, in respect R receives regular interest payments.
- T has a tax treaty with State S, equivalent to the treaty between R and S; in both treaties the withholding tax is limited to 10%.
- Establishing RCO is based on State R's robust securitisation framework, support services, extensive tax convention network etc. RCO is taxed on income earned and is entitled to full deduction for interest payments.
- in making its decision to sell receivables owed by enterprises in State S, the bank and RCO considered the existence of a benefit under the tax convention between S and R. This alone is *not* sufficient to speak of *principal purpose* to maintain benefit of the convention; you have to consider the context in which the investment was made.

Example M: real estate fund



- Investment strategy is not driven by tax positions of investors but is based on investing in certain real estate assets.
- RCO manages all of Real Estate Fund's immovable property assets and hold these assets indirectly through wholly owned companies resident of the States where the immovable property assets are situated.
- RCO is established for a number of commercial and legal reasons but also for the relief of withholding tax under the applicable tax treaty; this is easier done by one company than by each institutional investor.
- After a review of possible locations, Real Estate Fund decided to establish RCO in State R. This decision was mainly driven by the political stability of State R, its regulatory and legal systems, lender and investor familiarity, access to appropriately qualified personnel and the extensive tax convention network of State R, including its treaties with other States within the specific geographic area targeted for investment.
- RCO does not obtain treaty benefits that are better then that the investors would have if they had made the same investment directly.
- whilst the decision to locate RCO in State R is taken in light of the existence of benefits under the tax convention, it is clear that RCO's immovable property investments are made for *commercial purposes*. It would *not* be reasonable to deny the benefit of the Convention.

UK - Burlington - Upper Court Tribunal

Case involves 4 parties: (i) Burlington (Ireland) (ii) SICL (Cayman) (iii) Lehmann Brothers (UK, since collapsed), and Jeffries (USA)

SICL held debt of Lehmann. Lehmann owed accrued interest on this debt (principal paid). SICL sold the debt to Jeffries at 92% of the book value (1st assigned). At this point, SICL knew that the debt is going to be sold in the secondary debt market to Burlington in Ireland.

Burlington bought it at the 1st value + GBP 1 million. (all parties unrelated).

Lehmann paid the interest to Burlington, and withheld 20% tax as per domestic law. Burlington asked for Refund of the WHT.

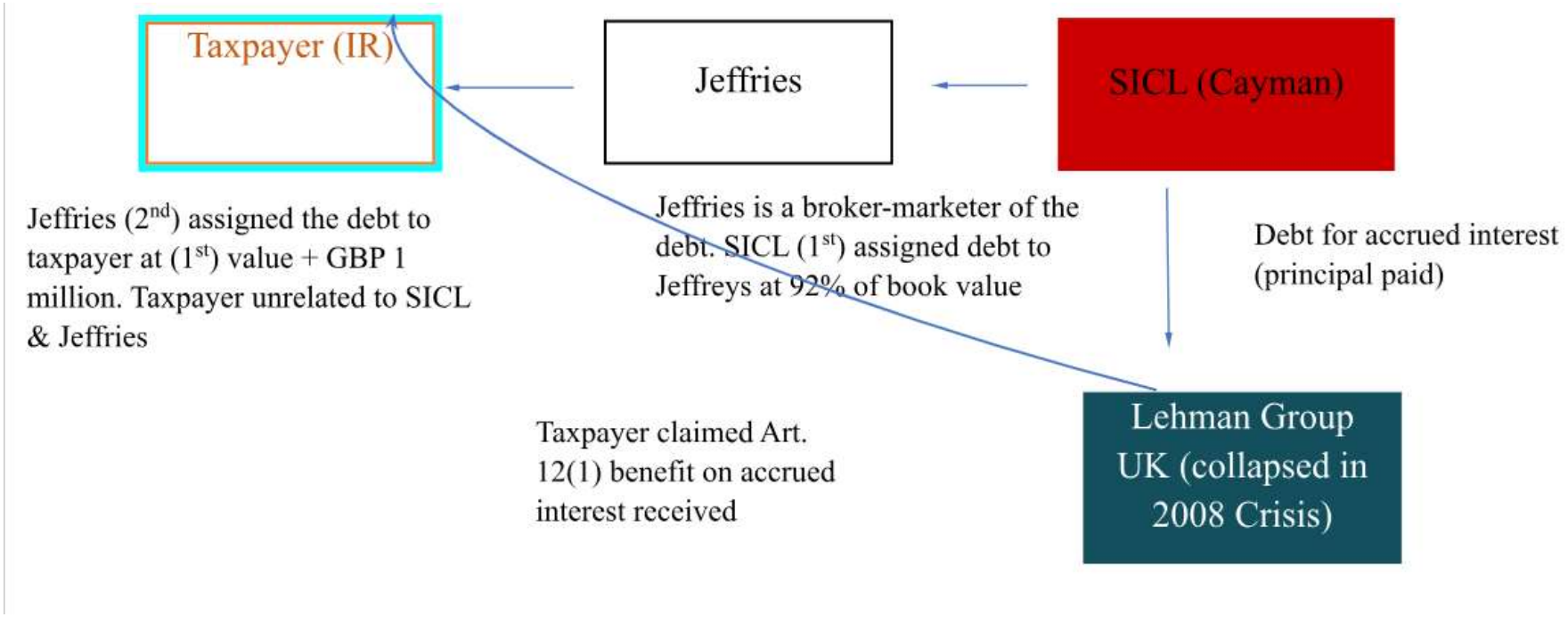
UK contd

Burlington sought refund under Art. 12(1) of UK-Ireland Treaty (exclusive resident state taxation.

Question: Whether restriction under Art 12(5) of UK Ireland treaty triggered?

"*5. The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the debt-claim in respect of which the interest is paid to take advantage of this Article by means of that creation or assignment.*"

UK continued - transaction flow



UK - cotd

Question of law: Did the taxpayer (Burlington), as a 'main purpose' in the assignment, itself 'take advantage' of Art 12(1) by means of the assignment?

View: No - There is a difference between a person's 'purpose' (reason) of doing something, and the person's implicit understanding of the 'consequence' of doing it. Taxpayer is long established company residing in Ireland, and had received UK source interest many times before (including of other claims of Lehmann group).

UK withholding tax was not a permanent cost for the taxpayer because of the tax residency in Ireland.

Thus, it was an 'inevitable consequence' of being resident in Ireland, and it is no different from receiving any tax benefits that the taxpayer enjoyed in Ireland by virtue of its status as a 'designated activity company' under the laws of Ireland. In other words, the tax benefits under the treaty was merely a part of the 'scenery'/'setting' in which the taxpayer made the offer to be assigned the debt claim in the first place.

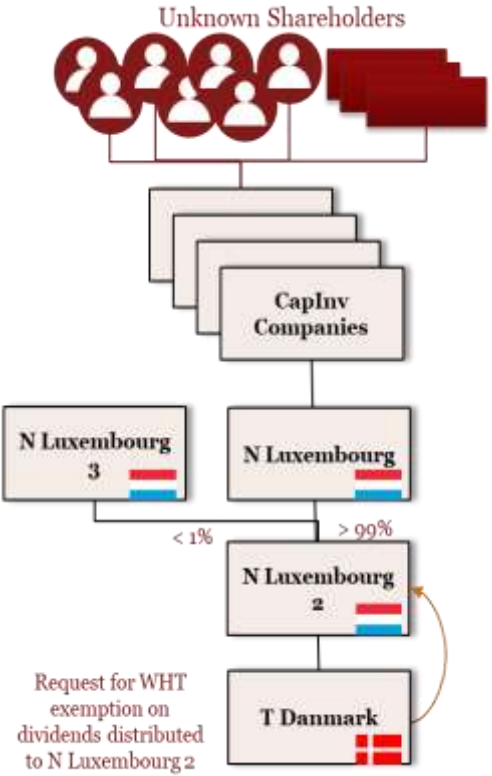
UK cotd

Question: Did SICL have, as a 'main purpose' in the assignment of the debt for accrued interest itself 'take advantage' of Art 12(1) by means of the assignment?

Held: There is a meaningful difference between (i) where the person disposes its debt-asset outright on a market price to a purchaser that has tax attributes that it does not have (ii) transactions involving conduits and treaty shopping (which Article 12(5) seeks to combat). Art 12(5) is limited to those cases where the seller retains an indirect economic interest in the transferred debt claim. Not applicable to an outright sale for a market price to an unrelated party.

Conclusion: Treaty benefits available.

Danish Beneficial ownership cases C-116/16



- Danish Ministry of Finance refused to confirm WHT exemption for dividends paid from T Danmark to N Luxembourg 2 as it was unclear how N Luxembourg 2 intended to dispose of the dividends.
- The higher tax commission changed that decision and issued a binding ruling presuming that the lion's share of the dividends of N Luxembourg 2 would be redistributed to N Luxembourg 3 and N Luxembourg, a small portion of the dividends would be used by the Luxembourg Corps to cover costs and that dividends distributed to N Luxembourg (as dividends and/or interest and/or debt repayments) would be channeled via the capital investment companies concerned to their shareholders. The Ministry of Finance appealed against that decision.

Denmark cotd

Is OECD-MC (especially its updates) to be considered for EU BO (Beneficial Ownership) qualification?

General Principles and BO requirements of the treaties:

“It follows that the general principle that abusive practices are prohibited must be relied on against a person where that person invokes certain rules of EU law providing for an advantage in a manner which is not consistent with the objectives of those rules.”

Constituent elements and abuse of BO:

“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.”

Denmark cotd.

104 The fact that a company acts as a conduit company may be established where its sole activity is the receipt of dividends and their transmission to the beneficial owner or to other conduit companies. The absence of actual economic activity must, in the light of the specific features of the economic activity in question, be inferred from an analysis of all the relevant factors relating, in particular, to the management of the company, to its balance sheet, to the structure of its costs and to expenditure actually incurred, to the staff that it employs and to the premises and equipment that it has.

Denmark cotd - Constituent elements and abuse of BO

105 Indications of an artificial arrangement may also be constituted by the various contracts existing between the companies involved in the financial transactions at issue, giving rise to intragroup flows of funds, by the way in which the transactions are financed, by the valuation of the intermediary companies' equity and by the conduit companies' inability to have economic use of the dividends received. In this connection, such indications are capable of being constituted not only by a contractual or legal obligation of the parent company receiving the dividends to pass them on to a third party but also by the fact that, 'in substance', as the referring court states, that company, without being bound by such a contractual or legal obligation, does not have the right to use and enjoy those dividends.

Poland- Polish Supreme Administrative Court (SAC)- II FSK 1466/23

Issue: Challenge by the Polish tax authorities regarding the exemption from withholding tax (WHT) on interest payments made by a Polish company (Polco) to its Dutch parent (NLCo). The authorities questioned NLCo's status as the beneficial owner (BO) of the interest.

Facts: Polco, a Polish company, paid interest to its Dutch parent company, NLCo, which is ultimately owned by entities in the USA and Canada. These entities are part of a global group that financed investments through back-to-back loans from companies in the USA and Canada to companies in Luxembourg and France, and subsequently to NLCo and Polco. The interest payments in question were made in 2017-2018. The Polish tax authorities argued that NLCo was not the BO under the domestic definition introduced in 2017 and amended in 2019, which required the recipient to engage in genuine economic activity and retain all economic risks associated with the interest. The Voivodeship Administrative Court (VAC) in Cracow ruled in favor of Polco, stating that the BO verification obligation only came into force on 1 January 2019 and could not be applied retroactively.

Poland- Cotd.

Judgement: Supreme Court applied the BO requirement retrospectively - based on the BO requirement from Article 11 (1)-(2) of the Poland-Netherlands treaty into domestic tax law (Article 21(3) CIT). Court also relied on the 2003 OECD Commentary on Article 11 for transactions in 2017-2018. The court examined the economic substance and tax avoidance purpose to determine BO status, retroactively applied the 2019 domestic BO definition, and failed to distinguish between BO and anti-abuse rules in Polish tax law.

Relationship LOB/PPT/BO/Anti-Conduit

- LOB only if treaty benefits otherwise available
- PPT only if treaty benefits otherwise available
- PPT may supplement LOB (‘nexus part’/ ‘transactions part’
- Beneficial ownership precedes application of LOB/PPT
- If BO test met, benefits may still be denied based on LOB/PPT or anti-conduit
- Look at LOB examples for PPT? And relevance of anti-conduit examples?

Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI) – and Action 6

- The purpose of the Convention is to swiftly implement the tax treaty-related BEPS measures. Consistent with that purpose, the *ad hoc* Group considered that the Convention should enable all Parties to meet the treaty-related minimum standards that were agreed as part of the Final BEPS package, which are the minimum standard for the prevention of treaty abuse under Action 6 (…).
- Paragraph 22 (page 19) of the Action 6 Report states that countries, at a minimum, should implement: (i) a PPT only; (ii) a PPT and either a simplified or detailed LOB provision; or (iii) a detailed LOB provision, supplemented by a mechanism that would deal with conduit arrangements not already dealt with in tax treaties.

Treaty interpretation; how does the Commentary connect?

Explanatory Statement MLI:

12. (…) Accordingly, the provisions contained in Articles 3 through 17 should be interpreted in accordance with the ordinary principle of treaty interpretation, which is that a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose. In this regard, the object and purpose of the Convention is to implement the tax treaty-related BEPS measures. The commentary that was developed during the course of the BEPS Project and reflected in the Final BEPS Package has particular relevance in this regard.

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