

Principal purpose test and CIL

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Topics

BEPS Action 6:PPT

PPT and CIL

PPT, CIL and Interpretation



OECD-BEPS

- BEPS Inclusive Framework 4 Minimum Standards: 128 countries
- BEPS MLI: In force as of 1 July 2018; 87 countries (signatories). MLI to modify bilateral tax treaties.
- Art. 29 OECD 2017 Model and Commentary: Entitlement to treaty benefits

1. BEPS Action 6: PPT

• **May 2017: Terms of Reference**

Preamble

Treaty provision that will take one of the following three forms:

- PPT
- PPT with either simplified or detailed LOB
- Detailed LOB with anti-abuse measures to counteract conduit financing

• **1st Report on compliance Action 6 by the BEPS Inclusive Framework now available.**

1. BEPS Action 6: PPT

Art. 6(1) An additional text in the preamble

“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 treaty shopping arrangements aimed at obtaining reliefs provided in this Convention for the **indirect benefit** of residents of third states)”

Art. 6(3) In addition a party may choose to include in the preamble

“Desiring to further develop their economic relationship and to enhance their co-operation in tax matters”

Relevant for the interpretation of the PPT (objective element).

1. BEPS Action 6: PPT

- **Article 7(1): 3 Elements PPT**

- **Benefit under a Covered Tax Agreement:** Art. 6 to 22, art. 23, and art. 24 of the OECD Treaty. It can also include tax sparing para. 175 Comm. Art. 29 2017 OECD Model) – Benefit (tax deduction, exemption, deferral or refund).
- **Subjective element:** *“if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit”* – **Tax Administration**
- **Objective element:** *“it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement”* - **Taxpayer**

1. BEPS Action 6: PPT

- Tax Administration and Taxpayer: Burden of proof.
 - Subjective element: **Reasonable** to conclude having regard to all relevant facts and circumstances that “one of the principal purposes...” Use of the word reasonable lower the burden for the tax authority vis-à-vis taxpayer.
 - Objective element: **Establish** that granting of a benefit in accordance with the object and purpose of the relevant treaty provisions. Taxpayer must refute clearly and unambiguously

Court a decisive role on whether or not the transaction arrangement satisfied the PPT. If not clear, the benefit of the doubt should go to the taxpayer (*V. Chand 2018*)

2. PPT and CIL

1. Reuven Avi-Yonah (2004): Is there a customary international tax law?
 - International Customary Law in international tax law e.g. CFC, definition sources of income, non-discrimination
 - Use of VCLT limited in international tax law

2. International Law Association – Study group international tax law (2018) <http://www.ila-hq.org/index.php/study-groups>
 - Sources of International Tax Law
 - Categorization of human rights applicable to taxation matters
 - The limits applicable to these rights in the framework of the global fight against tax avoidance and evasion

2. PPT and CIL

Is PPT international customary law?

Law that results from a general and consistent practice of states followed by them from a sense of obligation (Avi-Yonah 2004)

Opinio juris and state practice.

a) Before PPT: Guiding principle (para. 9.5. 2003 OECD Commentary to art. 1). No widely used by OECD countries.

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

2. PPT and CIL

- b) With PPT:** The use of PPT leads to customary international tax law.
- Widely accepted by members of the BEPS Inclusive Framework (128 countries) and also endorsed by 87 countries in the MLI (art. 7).
 - Issues to consider: the limitation in MLI to the covered tax agreements (CTA) and the mismatches between countries.
 - Example: Cyprus included the tax treaty (CTA) with the US in the MLI, but since the US has not signed the MLI, the PPT will not be applicable to the tax treaty between Cyprus and the US.

3. PPT, CIL, Interpretation

BEPS Action 6 including PPT are soft law (except if MLI).

a) If not MLI:

No binding but expectation that countries will adopt the BEPS Action 6.
Majority of countries have chosen PPT.

- Sources of interpretation: BEPS Action 6, Terms of Reference, Peer review reports

b) If MLI

Binding instrument, with a complex menu (reservations, options).
Applicable only to the covered tax agreements, thus, some tax treaties outside the MLI scope.

- Sources of interpretation: BEPS Action 6, Terms of reference, peer review reports, explanatory statement of MLI (referring to 2014 OECD Model).

3. PPT, CIL, Interpretation

c) 2017 OECD Model and Commentary: Entitlement to treaty benefits

Interaction between PPT and other tax abuse provisions, and also some clarification in the application of the elements of the PPT.

- Role of art. 3(2) OECD Model and of the VCLT. Interpretation: good faith, context, theological
 - With respect to the bilateral tax treaty? and
 - If MLI signed (with respect to the MLI)?
- MLI reference to 2014 OECD Commentary, thus, when to use the 2017 OECD Model and Commentary?
- Use of preamble, treaty provision, parliamentary discussions ratifying MLI, explanatory statement MLI.

Interpretation dynamic vs. static (at the time the MLI was signed, or MLI instrument was deposited)

4. Some issues for further research

- Two-steps approach: Object and purpose of (i) treaty in general AND (ii) relevant provisions in the treaty? ?
- Role of the explanatory memoranda and commentaries in the interpretation of the object and purpose?
- Still problems in interpretation of tax treaties create uncertainty (OECD new project). How to deal with this? Is the commentary to art. 29 (Entitlement to benefits) 2017 OECD Model sufficient? Static vs. dynamic ordinary meaning? Context?

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Further reading

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