

BEPS Action 6 Treaty Abuse: Cyprus

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Topics

**BEPS Action 6:
Terms of Reference**

**BEPS Action 6 and
MLI**

**Practical Problems
Application PPT**



OECD-BEPS

- BEPS Inclusive Framework 4 Minimum Standards: 127 countries
- BEPS MLI: 87 countries (signatories).
- Cyprus:
 - Not committed as BEPS Associate to the BEPS Inclusive Framework.
 - However, signatory of the BEPS MLI (61 CTAs). No yet in force, awaiting deposit instrument of ratification.

1. BEPS Action 6: Terms of Reference

- **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 available 15 February 2019.**

- **Position of Cyprus: BEPS Inclusive Framework vs. MLI signatories**

2. Cyprus: MLI

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”

Cyprus introduces text art. 6(1) and Art. 6(3) to all 61 CTAs.

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

2. Cyprus: MLI

Article 7 MLI: 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**

2. Cyprus: MLI

Notification of Existing Provisions (PPT) in Listed Agreements:

- Match: Cyprus list matches with Czech Republic (Protocol 2); Russia (art. 29); United Kingdom and Northern Ireland (Article 12(6). Should be art. 23 (2018 DTT)
- Mismatch: Cyprus includes Switzerland (Protocol 1). Switzerland does not.

3. Practical problems 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*)

3. Practical problems PPT

- ❑ Lower threshold: PPT: One of the principal purposes is a tax benefit. Arbitrary, but reduced if discretionary relief but still MAP will be needed.
- ❑ Medium threshold: GAAR: Main (sole) purpose a tax benefit. GAAR not applicable if economic substance (a minimal business activity, and there are tax and non-tax related motives). e.g. Northern Indiana Public Service Corp. v. Commissioner (115 F3d 506 (7th Cir. 1997))
- ❑ Higher threshold: Wholly artificial transactions or arrangements entered solely for the purpose of avoiding tax. e.g. Cadbury Schweppes CJEU case (see also Webber, 2017)

3. Practical problems PPT

One of the principal purposes vs. main purpose, sole purpose

- e.g. commercial reason and tax reason: PPT applies if “one of the principal purposes” is a tax reason
- However, balance tax purposes vs. genuine commercial/economic objectives. How this works in practice? See para. 181 Commentary to art. 29 2017 OECD Model
- Large tax benefit in taxation does not mean always application PPT – if in accordance to the object and purpose of the treaty

3. Practical problems PPT

- Two-steps approach: Object and purpose of (i) treaty in general AND (ii) relevant provisions in the treaty?
- Preamble: art 6(1) only “indirect benefit of residents of 3rd jurisdictions” and also in the definition of treaty shopping “indirectly the benefits”. How to interpret this?
- 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?

3. Practical problems PPT: Discretionary relief

- Art. 7(4) Optional provisions: Discretionary relief
- Cyprus chooses to apply art. 7(4) to CTAs
- *“Where a benefit under a Covered Tax Agreement is denied **to a person** under provisions of the Covered Tax Agreement (as it may be modified by this Convention) that deny all or part of the benefits that would otherwise be provided under the Covered Tax Agreement where the principal purpose or one of the principal purposes of any arrangement or transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits, the competent authority of the Contracting Jurisdiction that would otherwise have granted this benefit shall nevertheless treat **that person** as being entitled to this benefit, or to different benefits with respect to a specific item of income or capital, if such competent authority, upon request from that person and after consideration of the relevant facts and circumstances, determines that such benefits would have been granted to that person in the absence of the transaction or arrangement. The competent authority of the Contracting Jurisdiction to which a request has been made under this paragraph by a resident of the other Contracting Jurisdiction **shall consult with the competent authority** of that other Contracting Jurisdiction before rejecting the request”*

3. Practical problems PPT: Discretionary relief

These benefits would have been granted to the same person in the absence of the transaction or arrangement. No a minimum standard. Approx. 27 countries

- Problem: Not possible to grant treaty benefits to another (different) person
- Suggested: To change the same person for any person. To grant benefits regardless of the person to whom the benefits would have been granted. Para. 186 Commentary to art. 29 2017 OECD Model
- Discretion to competent authority and the other competent authority to be consulted before rejecting the request (burdensome- since it does not require approval only consultation but creates delays) See para. 185 Commentary to art. 29 2017 OECD Model.

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Further reading

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- B. Kuźniacki, “The Principal Purpose Test (PPT) in BEPS Action 6 and the MLI”, World Tax Journal, Vol. 10. No. 2. (2018)
- I.J. Mosquera Valderrama, “Output Legitimacy Deficits and the Inclusive Framework of the OECD/G20 Base Erosion and Profit Shifting Initiative”, Bulletin for International Taxation 72(3). (2018)
- P. Piantavigna, “The Role of the Subjective Element in Tax Abuse and Aggressive Tax Planning”, World Tax Journal, Vol. 10 No. 2 (2018)
- D. Weber, "The Reasonableness Test of the Principal Purpose Test Rule in OECD BEPS Action 6 (Tax Treaty Abuse) versus the EU Principle of Legal Certainty and the EU Abuse of Law Case Law", Erasmus Law Review, 1, (2017) pp. 48-59
- S. van Weeghel, A Deconstruction of the Principal Purpose Test, World Tax Journal, Vol. 11 No. 1. (2019)