



TAX TREATY ABUSE IN BEPS, ATAD AND NATIONAL LAW

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OECD-BEPS



- BEPS Inclusive Framework 4 Minimum Standards: 129 countries including Malta
- BEPS MLI: 87 countries (signatories), including Malta.



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** published 29 Feb. 2019 (116 jurisdictions –with information as of 30 June 2018)

2. Malta: BEPS Action 6 and MLI



- Signatory BEPS MLI (73 CTAs of 75 DTTs). Ratified 18 December 2018. Entry into force 1 April 2019.

- Position of Malta: BEPS Inclusive Framework vs. MLI excluded CTAs (Bulgaria and the United States)
 - Match: Also excluded by Bulgaria in the MLI; thus bilateral negotiation (Preamble/PPT)
 - The United States: no signatory MLI (Preamble/Detailed LOB and domestic anti-conduit rules (conduit financing arrangement rules: IRC Title 26 See IRC § 1.881-3)

- Position of Malta: CTA with Curaçao. No yet in force.
 - Match: Also included by Curaçao

2. Malta: BEPS Action 6 and 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”

Malta introduces text art. 6(1) and Art. 6(3) to all 73 CTAs.

- ❑ Some of the CTAs treaties prevent double taxation only, and others also fiscal evasion.
- ❑ Preamble: Relevant for the interpretation of the PPT (objective element)

2. Malta: BEPS Action 6 and MLI



Malta chooses to apply PPT to CTAs

Malta chooses to apply art. 7(4) to CTAs: Discretionary relief

“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”



3.1. PPT: Elements

□ Article 7(1) 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**



3.2. PPT: Burden of proof

- 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)



3.3. PPT: Subjective element

- ❑ Lower threshold: PPT: One of the principal purposes is a tax benefit. Arbitrary, but reduced if discretionary relief but still subject to consultation with the other tax administration.
- ❑ 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)



3.3. PPT: Subjective element

- 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 that 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
 - ▣ PPT discretionary relief (or not) may raise competition among countries since the tax administrations will have a discretionary power

- Some scholars: Recommend to choose for artificiality (objective –wholly artificial arrangements) instead of reasonable test (subjective) test. Desirable? And feasible in light of new CJEU development (see section 4 below).



3.4. PPT: Objective element

- 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?

4. Interaction PPT/GAARs/SAARS



2017 OECD Commentary to art. 29

- **PPT-SAAR:** (*para. 171*)
- *Lex specialis.* However, PPT wording: Notwithstanding any provisions of a covered tax agreement. Thus, PPT prevails over SAARs.
- PPT apply even if beneficial ownership (BO) requirement is satisfied, or if it has passed the LOB tests. LOB does not address all forms of treaty shopping
- PPT umbrella clause prevails over
- LOB , BO, SAARs (MLI art. 8(1) and art. 9(1)).
- SAAR: Based objective verifiable (often quantitative, safe harbor) parameters

Scholar (Danon). Not acceptable that still PPT can apply to extend the legal consequences provided therein to other situations beyond the scope of the SAAR.

- **Result: Uncertainty for taxpayer**

4. Interaction PPT/GAARs/SAARS



Anti-Tax Avoidance Directive 1 (ATAD 1)

Article 6 General anti-abuse rule.

1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the *main purpose or one of the main purposes* of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.
2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.
3. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law.

4. Interaction PPT/GAARs/SAARS



- Article 6: ATAD 1 effective 1 January 2019.
 - ▣ Main purpose or one of the main purposes
 - ▣ Valid commercial reasons reflecting economic reality
 - ▣ Other differences EU abuse and PPT see 2018 IFA EU Report GAARs and other rules.

- BEPS Action 6 Principal Purpose Test
 - ▣ One of the principal purposes is a tax purpose
 - ▣ Even if valid commercial reasons, if tax also an important reason, then, PPT will apply

EU Commission Recommendation 2017/136: Member States to align the CJEU case law as regards the abuse of law so that treaty benefits are also granted if the respective arrangement or transaction “**reflects a genuine economic activity**” (p.2).

4. Interaction PPT/GAARs/SAARS



EU approach vs. domestic GAARs

- Netherlands considers that *fraus legis* has the same effect as the Directive (IFA 2018 Report, the Netherlands). However, *fraus legis*: the **only or predominant** objective is a tax reason. Thus if *fraus Legis* case law used to interpret GAAR in ATAD 1, and if there are commercial reasons, then, the weight of the purposes will take place.
- Malta: art. 51 ITA complies with GAAR in ATAD 1. However, art. 51 refers: artificial or fictitious scheme/ sole or main purpose was the obtaining of any advantage. Thus if art 51 ITA used to interpret GAAR in ATAD 1, the “artificial element” will be relevant.

4. Interaction PPT/GAARs/SAARS



EU approach vs. domestic GAARs

1. Danish Beneficial Ownership Cases (C-115/16, C-118/16, C-119/16, C-299/16 and C-116/16 and C-117/16): ATAD 1, Parent and Subsidiary and, Interest and Royalties Directives

AG Kokott (main points to take in this interaction)

- Member States cannot rely on article 1(2) of the Directive (P&S) if it has not been transposed. However, the EU general principle to prevent abuse still applicable and to be interpreted and applied in accordance to EU law
- National rules to prevent abuse to be interpreted in conformity with EU Law (which is now codified in art. 6 ATAD 1 which provides for an “economic viewpoint approach”)
- Use of OECD for interpretation
 - Art. 29 2017 OECD Model and its commentary cannot have a direct effect on the interpretation of an EU Directive (and thus, on the interpretation of national law in conformity with EU Law).
 - Concept of beneficial owner to be interpreted under EU law autonomously and independently of the 1977 OECD Commentaries on art. 11.

4. Interaction PPT/GAARs/SAARS



CJEU

- General principle of EU law that EU law cannot be relied on for abusive or fraudulent taxpayers, can be directly applied by the national authorities and courts. Objective element purpose of the rule and subjective: intention to obtain an advantage from the EU rules by artificially creating the conditions laid down for obtaining it.

Para. 127. 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 the principal objectives** is to obtain a tax advantage running counter to the aim or purpose of the applicable tax law (CJEU C-115/118/119/299)

2. X GmbH (Case C-135/17) – Lowering of the abuse standard from wholly artificial arrangements to arrangements with primary objective or one of the primary objectives to artificially transfer of the profits (Kuźniacki, 2019)

5. Practical problems PPT:

Discretionary relief



Art. 7(4) No a minimum standard. Approx. 27 countries have chosen art. 7(4).

These benefits would have been granted to the same person in the absence of the transaction or arrangement

- 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.

- If not art. 7(4) can the tax treaty benefit still be granted especially if such benefits are available under domestic law mechanisms? (US treasury regulations 1.881-3 Conduit Financing Arrangements) For instance following the recharacterization of the transaction? (*V. Chand 2018*).

- Important for intermediary companies to provide sufficient non-tax reasons and economic substance for being located in a particular jurisdiction (including appropriate documentation). However, the facts and circumstances of the case will still determined the application of the PPT. (*V. Chand 2018*).

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