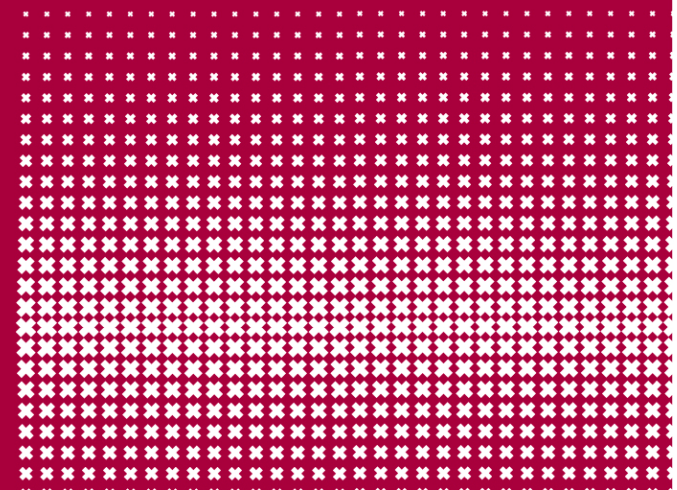




Prof.dr. Stef van Weeghel



International Tax Anti-avoidance in Practice and Tax Treaties

(General Anti-avoidance Rules)

Mumbai, 1 December 2011

IFA 2010 General Report – Part 1

- **Domestic anti-avoidance rules and tax treaties**
 - **Overview of domestic anti-avoidance rules**
 - **Relationship with tax treaty provisions**

- **Abuse of tax treaty itself**
 - **Addressed under domestic law principles, or**
 - **through interpretation of the treaty, taking into account object and purpose**

IFA 2010 General Report – Part 2

- **Tax treaty provisions that allow application of domestic anti-avoidance provisions**

- **General and specific anti-avoidance provisions in tax treaties**
 - **Tax treaty policy**
 - **Relationship between general and specific anti-avoidance provisions**
 - **Relevant case law**

General Report – Major findings

- Application of *general* anti-avoidance rules can generally be reconciled with tax treaty obligations
 - Statements made by OECD in 2003-changes are generally endorsed
 - Significant exceptions exist

- Application of *specific* anti-avoidance rules can sometimes but certainly not generally be reconciled with tax treaty obligations
 - CFC, thin-cap, recharacterisation, fictions, etc.

General Report – Major findings

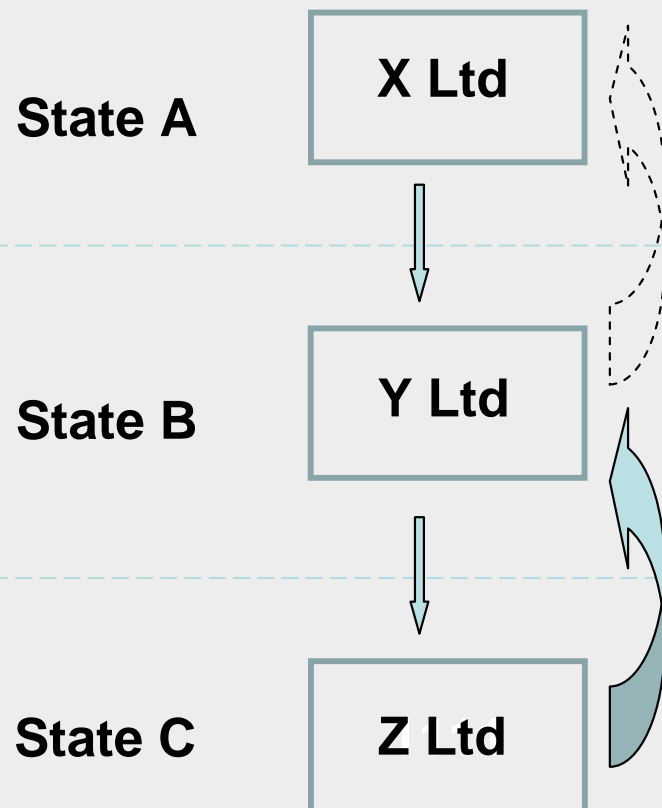
- **Abuse of the tax treaty**
 - **Distinction between abuse of domestic law and abuse of the treaty does not lead to different outcomes**
 - **Sometimes inquiry object and purpose of domestic law and tax treaty provision**
 - **Striking array of different outcomes in treaty shopping cases**
 - **Pacta sunt servanda vs.**
 - **Economic substance and tax avoidance motive**

General Report – Major findings

■ Tax treaty provisions

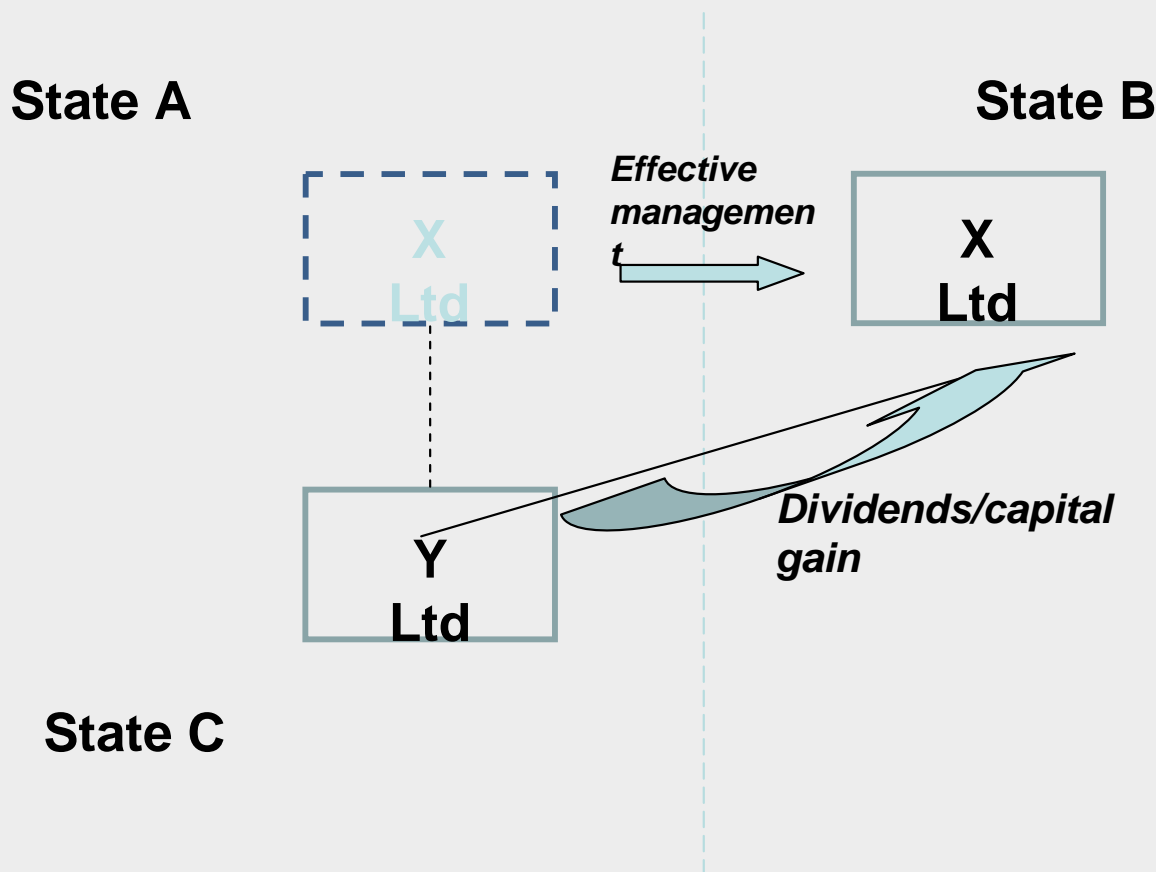
- Few tax treaties explicitly preserve application of domestic *general* anti-avoidance rules
- Application of domestic *specific* anti-avoidance rules is preserved more often
- Relatively few tax treaties contain *general* anti-avoidance rules
- Many tax treaties contain *specific* anti-avoidance rules
- Beneficial ownership continues to spark debate
- Surprisingly few countries have an LOB-policy

Tax Treaty Abuse – Treaty shopping



- No tax treaty between State A and State C
- Tax treaty between State B and State C reduces dividend/interest withholding tax
- Resident of State A interposes company resident of State B to obtain benefits of art. 10 (dividends), or, as the case may be, art. 11 (interest)

Tax Treaty Abuse – Transfer of Effective Management



- No tax treaty between State A and State C
- Tax treaty between State B and State C reduces dividend withholding and prevents capital gains tax in source state
- X Ltd., resident of State A, transfers effective management to State B to obtain benefits of art. 10 (dividends), or, as the case may be, art. 13 (capital gains) of tax treaty between State B and State C

Treaty Shopping - Cons and Pros

- | | |
|--|--|
| <ol style="list-style-type: none"> 1. Improper and contrary to purposes of treaties 2. Breaches reciprocity of a treaty and alters the balance of concessions 3. Contrary to principle of economic allegiance 4. Disincentive for countries to negotiate 5. Creates undesired revenue losses | <ul style="list-style-type: none"> · Some concessions are unilateral – “negotiated” balance not necessarily fair · Experts do not agree on nexus required – degree involved · Valid (easier to achieve reciprocity + cooperation) · No evidence – encourages cap’l + technology inflows to source countries (developing) |
| <ul style="list-style-type: none"> · Not all structures are artificial and devoid of substance | |



Tax Treaty Abuse - Approaches

- **Application of domestic rules**
- **Treaty interpretation**
- **Inherent anti-abuse rule in tax treaties?**
- **Beneficial ownership**

Tax Treaty Abuse

Striking down treaty abuse through application of domestic rules

OECD MC Commentary Article 1, §9.2:

"These States take account of the fact that taxes are ultimately imposed through the provisions of domestic law as restricted (...) by the provisions of tax conventions. Thus, any abuse of the provisions of a tax convention could also be characterized as an abuse of the provisions of domestic law under which tax will be levied. For these States the issue then becomes whether the provision of tax conventions may prevent the application of the anti-abuse provisions of domestic law (...)"

Tax Treaty Abuse

Striking down abuse through treaty interpretation

OECD MC Commentary Article 1, §9.3:

"Other states prefer to view some abuse as being abuses of the convention itself, as opposed to abuses of domestic law. These states then consider that a proper construction of tax conventions allows them to disregard abusive transactions, such as those entered into with the view to obtaining unintended benefits under the provisions of these conventions. This interpretation results from the object and purpose of tax conventions as well as the obligation to interpret them in good faith (see Article 31 VCLT)."

Tax Treaty Abuse

Striking down treaty abuse – a guiding principle

OECD MC Commentary Article 1, §9.5:

"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."

Treaty shopping – Case law

- ***A Holding (Switzerland) vs. BNB 1994/253 (The Netherlands) + Prévost (Canada)***
 - Dividends
 - Treaty benefits denied based on abuse (inherent anti-abuse)
 - Treaty shopping is ok
 - Intermediate holding is beneficial owner (BO)
- ***Indofood vs, Transportasi Gas (Indonesia)***
 - Interest
 - Hypothetical conduit is not BO
 - Dutchco is BO

Treaty shopping – Case law

- ***Aiken Industries vs. NIPSCO (U.S.)***
 - Interest
 - "*No dominion and control*"
 - "*Recognizable business*"

Treaty Shopping – Case law

- ***Crown Forest (Canada, 1995)***
 - Interpretive presumption against treaty shopping
 - *"Although there is nothing improper with choosing the most beneficial international tax regimes, it should not be encouraged nor promoted by judicial interpretation of existing agreements"*
 - *"Treaty shopping (...) would be patently contrary to the basis on which Canada ceded its jurisdiction to tax as the source country, namely that the U.S. as the resident country would tax"*
- ***MIL Investments SA (Canada, 2007)***
 - ***Obiter:*** nothing inherently improper with selecting one foreign regime over another

Transfer of residence – Case law

- ***Yanko Weiss Holding (Israel) vs. BNB 2007/42 (The Netherlands) + MIL (Canada)***
 - **Treaty benefits denied based on abuse (inherent anti-abuse)**
 - **Rigid literal interpretation**
 - **Treaty shopping is ok; no avoidance transaction**

Inherent Anti-abuse Rule in Tax Treaties?

- **Art. 26 and 31 VCLT (Can treaty benefits be denied based on good-faith-application / interpretation?)**
 - **ICJ dissenting opinion Judge Alvarez**
 - **Vogel & Ward**
 - **Case law:**
 - **Present: *A Holdings* and *Yanko Weiss*,**
 - **Not present: *MIL* and Dutch Supreme Court (various cases)**

Tax Treaty Abuse – Beneficial Ownership

- Introduced in 1977 OECD Model Convention and Commentary
 - Term is not defined in Model
- France and Switzerland: even absent BO concept in treaty, BO still a requirement for source State reduction
- Mixed picture: to be defined in domestic law OR autonomous / international meaning?
 - Government view in The Netherlands and U.S.: leeway through Art. 3(2) for interpretation with reference to domestic law
 - *Indofood*: international fiscal meaning (OECD MC Commentary)

Tax Treaty Abuse – Beneficial Ownership

- **Mixed picture: to be defined in domestic law OR autonomous / international meaning?**
(Ctd')
 - ***Prévost*: unclear whether contextual, international fiscal or domestic meaning (reference though to interpretation under other State's law)**
 - ***Transportasi Gas* (Indonesia, 2008): international fiscal meaning to be determined by the State of residence, exchange of information between States**
 - **China: *Notice 601* – negative elements**
 - **Business activities, assets, employees, subject-to-tax, back-to-back**
- **Clarification of the meaning in Commentary – OECD Discussion draft 29 April 2011**
 - **Contextual meaning; narrower than some would expect, but specifically leaving room for anti-abuse rules**

Summary and conclusions

- **On very similar fact patterns courts in different jurisdictions (and even in the same jurisdiction) come to diametrically opposite results**
- **Not satisfactory**
- **Reasons?**
 - **Appreciation of facts**
 - **Judicial methodology**
 - **Different approaches to fundamental questions (e.g. inherent anti-abuse rule, interpretation of BO)**
 - **Different policies of states towards tax avoidance and treaty shopping**
 - **Willingness of courts to rely on Commentary and to apply posterior Commentary to earlier treaties**