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The application of GAARs in multilateral tax legislation – A comparative research between the GAAR provided by the EU Anti-Tax Avoidance Directive and the PPT rule suggested in the OECD's BEPS Action Plan 6.

To what extent are the GAARs under consideration effective considering the coordination issues arising due to the application of different GAAR in each legal framework?

by

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Master's Thesis

Master's Program in International Business Taxation/Track: International Business Tax Law 2016/2017.

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Date: 19.6.2017

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Abstract

The field of international tax law has changed dramatically in the last few years. The growing concern of developed countries from loss of revenues due to international tax planning undertaken by MNEs led them to cooperate in order to confront that phenomenon. This cooperation resulted in several legal frameworks addressing the issue of BEPS, including the OECD's BEPS Project and the EU Anti-Tax Avoidance Directive. Surprisingly, even though the EU member states are considered leaders in the OECD, numerous mismatches can be found between the solutions applied in both systems. Those mismatches make it more difficult to coordinate between those legal frameworks and question the effectiveness of both methods, which considers international cooperation to be an important factor for confronting BEPS.

In this thesis I address a specific measure adopted by both the BEPS Project and the EU Anti-Tax Avoidance Directive: the application of a GAAR. The rules evaluated in this thesis are the GAAR provided by the new EU Anti-Tax Avoidance Directive, and the PPT rule provided by Action plan 6 of the BEPS Project. The purpose of both rules is the same – to confront certain tax planning schemes which circumvent current tax rules and avoid the application of existing SAARs, resulting in a lower tax burden. However, these rules rely on different concepts of tax avoidance and provide for a completely different solution to that phenomenon. This research investigates both rules and related tax avoidance concepts in order to evaluate the effectiveness of each rule by itself, and the impact of issues of (lack of) coordination between the rules on their effectiveness.

Abbreviations

ATA	Anti-Tax Avoidance
ATAD	The Anti-Tax Avoidance Directive
BEPS	Base Erosion and Profit Shifting
BRIC	Brazil, Russia, India and China
CCCTB	Common Consolidated Corporate Tax Base
CFC	Controlled Foreign Company
CIT	Corporate Income Tax
CJEU	Court of Justice of the European Union
EU	European Union
G20	The Governmental forum of the 20th largest economies
GAAR	General Anti-Abuse Rule
IP	Intellectual Property
LOB	Limitation on Benefits
MNE	Multinational Enterprise
MS	Member State of the European Union
MTC	Model Tax Convention of the OECD
OECD	Organization for Economic Cooperation and Development
OEEC	Organization for European Economic Co-operation
PE	Permanent establishment
PSD	Parent-Subsidiary Directive
PPT	Principle Purpose Test

R&D	Research and Development
SAAR	Specific anti-abuse rule
TEU	Treaty on the European Union
TFEU	Treaty on the Functioning of the European Union
UN	The United Nations
US	The United States of America

Chapter 1: Introduction

1.1 Background

Following the last decade, the issue of BEPS attracted increasing political attention. Politicians began to publicly show their concern regarding tax planning performed by MNEs, resulting in much lower tax revenues for the OECD member countries. MNEs are using the gaps between two (or more) different tax jurisdictions, and artificially reducing taxable income or shifting profits to almost no tax jurisdictions.[1] The roots of this harmful practices lies on the outdated formula of international tax law which was developed in the 1920's and adopted by all democratic constitutional states and by the OECD itself. The key element of that formula is the allocation of taxing rights based on physical-geographical concepts, represented by principles of residence and source. More and more countries began realizing that in our globalized world where capital can be shifted easily between countries, the old perceptions that shaped the leading principles of international tax law are outdated and need to be modified.[2]

The need to confront tax avoidance schemes which involves international aspects, led to the creation of new international tax law instruments based on cooperation and joint actions by countries. In 2015 the OECD, supported by the G20, published final reports combined by an Action plan package for confronting BEPS (hereinafter: **"BEPS Project"**). Eventually, 15 comprehensive reports including detailed recommendations on different tax issues were published in October 2015.[3] Soon after, in January 2016, the European Commission published its proposal for a council directive on rules against tax avoidance practices that directly affect the functioning of the internal market, as part of the European Commission's ATA Package.[4] A slightly different version of this directive was approved by the European Parliament in July 2016.[5]

As described in the explanatory memorandum of the ATAD proposal, one of the targets of this directive is to respond to the final reports of the BEPS Project. MSs are also members of OECD, and hence are committed, to some degree, to implement the measures recommended by the BEPS Project. The EU Commission wished to ensure that MSs are not implementing the BEPS Project recommendations in a

[1] OECD (2015), Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project, p. 4-5, OECD. (Hereinafter: **"BEPS Project's Explanatory Statement"**)
[2] Yariv Brauner, *What The BEPS?*, 16 Fla. Tax Rev. 55, p. 61-68, 2014. (Hereinafter: **"Brauner"**).
[3] BEPS Project's Explanatory Statement, p. 13-19.
[4] Council Proposal for a Directive Laying Down Rules Against Tax Avoidance Practices That Directly Affect The Functioning of The Internal Market, 2016 O.J. C 26, 28.1.2016. (Hereinafter: **"ATAD Proposal"**)
[5] Directive 2016/1165/EC of the Council on Laying Down Rules Against Tax Avoidance Practices That Directly Affect The Functioning of The Internal Market, 2016 O.J. L 193/1, 19.7.2016. (Hereinafter: **"ATAD"**).

non-unified manner, which would create new loopholes and mismatches in the EU internal market. It was therefore of great importance to provide a directive that addresses the issues dealt with by the BEPS Project before MSs commence with the implementation process. Moreover, it was obvious that several adjustments of the BEPS Project's recommendations would have to be made in order for it to comply with EU law.[6] One must bear in mind that the primary purpose of EU law regarding taxation is to secure the internal market and tax neutrality, and this is done through the protection of EU fundamental freedoms. Controversially, the primary aim of the BEPS Project is to confront tax planning structures that are the cause of the BEPS phenomenon. Consequently, the adoption of a different set of rules by the EU Commission was unavoidable since MSs have to respect the limitations of EU law even when they confront harmful tax practices.[7]

As a result, numerous mismatches are found between the ATAD and the BEPS Project. This thesis focuses on the differences between the GAARs provided by the ATAD and the BEPS Project. Article 6 of the ATAD provides for a GAAR, aiming at tackling *"non-genuine arrangements",* one of main purposes of which is to obtain tax advantage and has no valid economic reason.[8] The BEPS Project's Action 6 on preventing the granting of treaty benefits in inappropriate circumstances also provides a GAAR based on a PPT rule, aimed at preventing situations of treaty abuse.[9] Although both rules are GAARs aimed at confronting the same abusive behavior, there are more differences than similarities between them. The GAAR provided by the ATAD is based on the EU concept of tax avoidance which was concluded in many cases of the CJEU. The principal case regarding the EU concept of tax avoidance is that of Cadbury Schweppes, in which the court concluded that a taxpayer will be engaged in abusive practices only if the arrangements he conducted are considered as *"wholly artificial arrangements"*.[10] This artificial requirement is reflected by the GAAR provided by the ATAD which aims at confronting only situations involving *"non-genuine arrangements"*.

The PPT rule provided by Action 6 resides on a different concept of tax avoidance. The BEPS Project is actually a joint act by countries calling for a complete reform in the field of international taxation. The recommendations have taken a comprehensive and holistic approach, allocating profits to the jurisdiction

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[6] ATAD Proposal, Explanatory Memorandum, p. 3-4.
[7] Rita C. Cunha, *BEPS Action 6: Uncertainty in the Principal Purpose Test Rule,* Global Taxation Vol.1 186, p. 186-189, June 2016. (Hereinafter: **"Cunha"**).
[8] ATAD, Article 6.
[9] OECD (2015), Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, p.55, paragraph 7, OECD Publishing, Paris. (Hereinafter: **"Action 6"**).
[10] Case C-196/04 Cadbury Schweppes plc v. Commissioners of Inland Revenue, [2006] ECR I-8031. (Hereinafter: **"Cadbury Schweppes"**).

where value was created and aggressively confronting tax planning schemes.[11] The most obvious difference between the GAARs is the lack of any artificial requirement through the PPT rule. Other significant differences are found between the GAARs, such as the burden of proof and the standard of proof. Generally speaking, the PPT rule is biased in favor of tax authorities while the GAAR provided by the ATAD tends to take the taxpayer's rights more seriously.[12]

A conflict between those two provisions will arise in situations where a cross-border transaction takes place involving a MS that adopts the PPT rule as a provision found in its tax treaties while its domestic legislation includes a GAAR based on the GAAR provided by the ATAD. Therefore, a highly fundamental question is the compatibility of both GAARs with EU law, and the possibility for MSs to include the PPT rule in their tax treaties. In addition, the possibility of coordinating with those conflicting rules has a major impact on the legal certainty of taxpayers, and hence on the effectiveness of those provisions. This thesis will focus on the tax avoidance concept on which each GAAR is based, the effectiveness of both rules, the conflicts between the rules, and the possibility of coordinating in the event that both GAARs apply.

1.2. Research and sub-research questions

To what extent are the PPT rule and the GAAR provided by the ATAD effective for the purpose of confronting tax avoidance, also considering the coordination issues arising due to the application of different GAARs in the international and EU legal systems?

<u>1. To what extent are the GAARs under consideration effective?</u>

a. What is the tax avoidance concept governing both GAARs?

b. To what degree does each GAAR provides legal certainty?

c. To what extent can each GAAR confront abusive practices that would otherwise result in revenue loss, without hindering free trade?

<u>2. Does the interaction between the GAARs have a negative impact on their effectiveness?</u>

a. What are the differences between the GAARs?

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[11] BEPS Project's Explanatory Statement, p.9.

[12] Frans Vanistendael, *Is Tax Avoidance the Same Thing under the OECD Base Erosion and Profit Shifting Action plan, National Tax Law and EU Law?* IBFD Bulletin For International Taxation 163, p. 168-169, March 2016. (Hereinafter: **"Vanistendael"**).

b. Do the differences between the GAARs create coordination issues in case of parallel application of both GAARs?

c. What modifications should be made in order to settle coordination issues and maximize the effectiveness of both GAARs?

1.3. Motivation of study

The recommendations laid down by the BEPS Project have the potential to cause a revolution in the generally accepted legal framework which currently dominates the field of international tax law. Since the publication of the final reports of the BEPS Project, a massive quantity of opinions was written about it, reflecting its importance. The BEPS Project involved more than 90 countries, and as such has an impact on most of the countries in the world.[13] Moreover, the OECD member countries, which are the most developed countries in the world, are, to a certain level, committed to the BEPS Project.

Much criticism was directed at the final reports of the BEPS Project, claiming that there is no chance of those recommendations being implemented by a sufficient number of countries, and pointing out the harmful effects it could have.[14] It might be too early to say, but the adoption of a different set of rules by the EU is a step in that direction. By investigating the changes made by the EU to some of the BEPS Project recommendations, it is possible to effectively determine which of the BEPS Project recommendations might frustrate the accomplishment of its aims. In addition, such an examination also provides insight on the new obstacles that may rise due to countries' inability to cooperate in the field of international taxation.

GAARs, by their nature as completing measures which enables tax authorities to confront tax avoidance practices that no other measure is suitable for confronting, inherently do not provide for a high degree of legal certainty. GAARs are usually phrased broadly, trying to catch new tax planning schemes that circumvent current SAAR.[15] As such, intensive use of a GAAR increases the compliance burden on taxpayers and the administrative burden on tax authorities. These features do not prevent most of the countries in the world from adopting a GAAR, which is considered as a mandatory anti-avoidance measure in modern tax legislation. Considering the importance of GAARs in tax legislation and the different approaches taken by the EU Commission and the BEPS Project regarding it, a comparison

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[13] BEPS Project's Explanatory Statement, p. 4-5.

[14] For example, see: Jason J. Fichtner & Adam N. Michel, *The OECD'S Conquest of the United States: Understanding the costs and Consequences of the BEPS Project and Tax Harmonization*, Mercatus center at George Mason University, Arlington VA, p. 31-35, March 2016. (Hereinafter: **"Fichtner & Michel"**).

[15] ATAD Proposal, p.9.

focusing on those differences is suitable for understanding what are the main considerations taken by countries when designing tax avoidance measures in the aftermath of the BEPS Project.

The conflicts that may arise between the PPT rule and the GAAR provided by the ATAD are not only theoretical ones. The PPT rule is about to be adopted by the OECD's Model Tax Convention,[16] which most of the developed countries in the world follows as the basis for their bilateral tax treaties.[17] Hence, it is reasonable to conclude that when the PPT rule is finally added to the MTC it will be implemented by a respectable number of countries. Therefore, the interaction between the PPT rule and domestic GAARs is unavoidable, with the outcome of coordination issues. Those issues are of great importance, particularly due to the approach adopted by the BEPS Project, which stipulates that the issue of international tax planning should be confronted through cooperation and joint actions rather than through unitary ad-hoc solutions. This thesis includes an innovative solution that in my opinion has the potential to eliminate the predicted exhaustion of effectiveness of both the PPT rule and the GAAR provided by the ATAD due to coordination issues.

1.4. Methodology

In this thesis I conduct a comparative research between the GAAR provided by the ATAD and the PPT rule. This research has three aims: to reliably evaluate the effectiveness of both rules in confronting tax avoidance, to evaluate the possibility of coordination between the rules, and ultimately to evaluate the impact of any lack of coordination on the effectiveness of the rules. For the purposes of this research, two parameters are used in order to evaluate the effectiveness of a GAAR:

1. The influence of the GAAR on legal certainty.

2. The ability of the GAAR to confront abusive practices that otherwise would result in revenue loss, without hindering free trade.

A secondary evaluation of the effectiveness of the GAARs is provided in the last chapter of this thesis, taking into account the impact of the coordination issues. Each rule will be examined in the light of the legal framework on which it is based, meaning the tax avoidance concept of the EU and the concept of abuse adopted by the MTC. The comparison between the rules will focus on the coordination between them and on the obstacles arising due to lack of coordination. The information provided in this thesis is

[16] Last version: OECD (2014), *Model Tax Convention on Income and on Capital 2014 (Full Version)*, OECD Publishing. (Hereinafter: **"MTC"**).
[17] Michael Lang, Introduction to the Law of Double Taxation Conventions, 2nd edition, Linde Verlag, P. 33-34, 2013. (Hereinafter: **"Lang"**).

based mainly on academic articles published by known law journals, CJEU case law, the BEPS Project final reports, EU directives and official publications, and professional discussion papers.

1.5. Delimitation

This thesis is devoted to the examination of two GAARs: the GAAR provided by the ATAD, and the PPT rule provided by Action 6. In order to clearly understand the GAARs under consideration, I will address the tax avoidance concepts ruling them. As for the GAAR provided by the ATAD, I review the CJEU case law on tax avoidance. As for the PPT rule, I will present the tax avoidance concept it is relied upon as reflected by the MTC Commentary and other discussion papers of the OECD.

I will address other anti-avoidance measures such as SAARs only in certain places and only in order to explain the concept of tax avoidance on which each GAAR is based. As for the BEPS Project, I address only the PPT rule provided by Action 6. Therefore, I will not discuss the LOB provisions provided by this action or any other recommendation of the BEPS Project. Similarly, I will address only the GAAR provided by the ATAD, and will not consider any other provisions found in that directive. I will refer to other EU legislation or BEPS Project recommendations only in certain places and in order to explain the impact of each tax avoidance concept on other areas of tax legislation.

1.6. Benchmark

There are two legal frameworks in which I prove my thesis. The GAAR provided by the ATAD is examined under the EU tax law, provided by the relevant EU directives and regulations, the CJEU case law, EU Commission's communications and recommendations, and the fundamental freedoms of the EU. The PPT Rule provided by Action 6 is examined under the general accepted principles of international taxation which are reflected by the MTC, its Commentary, and the innovative approach taken by the OECD in its BEPS Project.

1.7. Outline

Chapter 2, which deals with the GAAR provided by the ATAD and chapter 3, which deals with the PPT rule, have a similar formation. First, I present the tax avoidance concept on which the GAAR under consideration is based. Second, I discuss the general reasons for adopting the two legal tools in which the GAARs appear – the ATAD and Action 6. Third, I describe the role that each GAAR has in its legal framework. Finally, I evaluate the effectiveness of each GAAR using the formula described in part 1.4.

Chapter 4 includes a comparison between the two GAARs. First, I consider the compatibility of the PPT rule with EU law. Second, I analyze the conflicts that would arise in cases which both the GAAR

provided by the ATAD and the PPT rule may apply. Further, I reconsider the effectiveness of the GAARs, taking into account the conflicts and coordination issues between them. Finally, I suggest a solution that has the potential to eliminate the main concerns arising due to those conflicts and coordination issues.

Chapter 2: The GAAR provided by the ATAD

2.1 Introduction

The reaction of the EU legislators to the publication of the BEPS Project recommendations was very quick in terms of EU legislative procedures in the field of direct taxation. Actually, the adoption of the ATAD began even before the release, in October 2015, of the final reports of the BEPS Project, when the General Secretariat of the EU Council urged the EU Commission *"to advance efforts in the fight against tax avoidance and aggressive tax planning"* in its conclusion document for the year 2014.[18] The first proposal for the ATAD was delivered in January 2016, less than six months after publication of the BEPS Project final reports. The main reason for that immediate reaction was the existence of a unique community law concept of tax avoidance that was developed by the CJEU case law, which made the overall discussions on the ATAD less complex.

In order to evaluate the effectiveness of the GAAR provided by the ATAD, it is necessary to understand the EU concept of tax avoidance on which it is based. Hence, this Chapter will begin with an overview of the build-up of that concept in CJEU case law, focusing on the decisions in three landmark cases – Halifax[19] (on indirect taxation), Cadbury Schweppes and Thin Cap[20]. I will then analyze the GAAR provided by the ATAD, focusing on the objective, subjective, and artificial elements that determine whether a MS has the right to reclassify certain artificial arrangements for tax purposes. Finally, I will evaluate the effectiveness of the GAAR provided by the ATAD in confronting abusive behavior.

2.2. The concept of tax avoidance in EU law

2.2.1. The concept of tax avoidance in EU directives

Direct taxation, as well as indirect taxation, comes under the heading 'internal market' in Article 4(2)(a) of TFEU.[21] It means that the EU legislators may harmonize those fields, usually by directives and regulations. Unlike indirect taxation, there were only small moves towards harmonization on direct

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[18] General Secretariat of the Council Conclusion EUCO 237/14 on the meeting of 18 December 2014, Article 3.

[19] Case C-255/02 Halifax plc v. Commissioners of Customs & Excise, [2006] ECR I-1655. (Hereinafter: **"Halifax"**).

[20] Case C-524/04 Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue, [2007] ECR-I 2157. (Hereinafter: **"Thin Cap"**).

[21] Consolidated Version of the Treaty on the Functioning of the European Union, Article 4(2)(a), 2012 O.J. C 326/01, 26.10.2012. (Hereinafter: **"TFEU"**).

taxation issues, which reflect the unwillingness of MSs to waive their sovereignty in that field.[22] In the few EU sources devoted to direct taxation, until approval of the ATAD there was no recognition of a coherent community tax avoidance concept, though many of its elements had been subjected to a certain degree of harmonization through the CJEU case law. The anti-avoidance provisions found in the directives that I review in this sub-part have been amended in accordance with the CJEU case law. Hence, the purpose of this sub-part is to provide a brief look at the non-unified concept of tax avoidance in the EU prior to the CJEU case law on this issue.

The definition of tax avoidance and the measures that should be taken to confront it were left to the discretion of MSs, while some broad boundaries were set by different EU directives.[23] Article 1(2) of the old Parent-Subsidiary Directive[24] and Article 27.1 of the Sixth directive[25] (the old VAT directive) allowed MSs to apply domestic provisions required for the prevention of fraud or abuse, without setting any formal limitations on that power. Article 15(1)(a) of the old Mergers Directive[26] concluded that the lack of 'valid economic reasons' could construct a presumption of abuse. However, this Article did not elaborate what the impact of existence of 'valid economic reasons' on the occurrence of abuse. Therefore, a MS was allowed to deny the granting of any benefit of the directive in a broad range of situations. It only required that the principal objective of the relevant action be 'tax avoidance' or 'tax fraud'. A more precise instruction was given in the Savings Income Directive,[27] which required that the domestic measures would not constitute arbitrary discrimination or restriction on the free movement of capital.

At first glance, those provisions demonstrate the lack of harmonization in EU level on the issue of defining and preventing tax avoidance. There was no clear direction in which the MSs were willing to go to determine a single concept of tax avoidance through the EU. However, the interpretations that the CJEU gave to those provisions, coupled with different principles followed by it in other tax cases (mainly

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[22] B.J.M. Terra & P.J Wattel, European Tax Law, FED Fiscale Studieserie, 6th edition, p. 7-8, 2012. (Hereinafter: **"Terra & Wattel"**).
[23] Prof. Violeta Ruiz Almendral, *Tax Avoidance and the European Court of Justice: What is at Stake for European General Anti-Avoidance Rules?,* Intertax Vol. 33 Issue 12 562, p. 570-571, 2005. (Hereinafter: **"Almendral"**).
[24] Directive 90/435/EEC of the Council on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States, 1990 O.J. L 225, 23.7.1990.
[25] Directive 77/388/EEC of the Council on the Harmonization of the Laws of the Member States Relating to Turnover Taxes – Common System of Value-Added Tax: Uniform Basis of Assessment, 1977 O.J. L 145, 13.06.1977. (Hereinafter: **"The Sixth Directive"**).
[26] Directive 90/434/EEC of the Council on the Common System of Taxation Applicable to Mergers, Divisions, Transfers of Assets and Exchange of Shares Concerning Companies of Different Member States, 1990 O.J. L 225, 20.08.1990.
[27] Directive 2003/48/EC of the Council on Taxation of Savings Income in the Form of Interest Payments, 2003 O.J. L 157/38, 26.6.2003.

taxpayers claiming for discrimination in applying domestic SAAR) did formulate a basis for a complete concept of tax avoidance within the EU.[28]

2.2.2. The development of an EU concept of tax avoidance through the CJEU case law

As mentioned in sub-par 2.2.1, MSs were unwilling to waive any of their sovereignty in direct taxation matters. The EU directives on direct taxation laid down only mandatory provisions for situations of cross-border activities (e.g. cross-border mergers and holdings) and did not impose any boundaries on the MSs power to tax domestic activities. Hence, each country used a different type of anti-avoidance provisions, disregarding any doctrine of abuse derived from EU law.

The existence of 28 different concepts of tax avoidance through the EU created conflicts with the fundamental freedoms provided by the TFEU: the free movement of goods[29], citizens[30], workers[31], capital and payments[32], freedom of establishment[33], and the prohibition on discrimination[34]. The most important notion of these freedoms in the light of the field of direct taxation is the right to engage in cross-border activities (freedom of establishment) combined with the prohibition of discrimination on the ground of nationality or origin. MSs are obliged to apply their tax rules in compliance with the non-discrimination principle, hence they are prohibited from treating other nationals (individuals or undertakings) differently from their own nationals.[35] The CJEU clarified that the lack of harmonization in the field of direct taxation cannot justify derogations from the fundamental freedoms of the EU, and that MSs must comply with EU law in any case.[36]

That situation was confusing, particularly due to the existence of a doctrine of abuse of EU law that was developed by the CJEU in non-tax cases. This doctrine permitted MSs to restrain one of the EU fundamental freedoms if its action could be justified by the need to prevent abuse of laws. It was concluded that nationals of MSs could not attempt improperly to circumvent their national legislation by

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[28] Almendral, P.571.
[29] TFEU, Articles 34-35.
[30] TFEU, Article 21.
[31] TFEU, Article 45(2).
[32] TFEU, Article 63.
[33] TFEU, Article 49(1).
[34] TFEU, Article 18.
[35] Case C-279/93 Finanzamt Koln-Altstadt v. Roland Schumacker, [1995] ECR I-250, paragraph 21-22.
[36]Case C-270/83 Commission of the European Communities v. French Republic, [1986] ECR 285, paragraph 23-24. (Herinafter: **“Avoir Fiscal”**).

taking advantage of provisions of EU law.[37] However, an objective abuse of law is not sufficient for a MSs to restrict a fundamental freedom. There needs to be a subjective intent to engage in the abusive behavior in a way that contradicts the objectives of the relevant provisions of community law or fundamental freedom.[38] This general EU doctrine of abuse was finalized in the CJEU Emsland-Starke case.[39] This case involved a company that was exporting products to a third state (Switzerland), and immediately importing the same products back to the EU (through Germany or Italy). This scheme took advantage of the higher amount of export restitutions than the customs duties upon importation. The court formulated for the first time the subjective and objective tests for establishing an abuse of EU law that permits MSs to restrict fundamental freedoms.[40] Eventually, these tests were applied to tax matters in the Halifax case which will be discussed in the next sub-part.

A distinction must be made between discriminatory measures and restrictive measures. A discriminatory measure can be justified only by a precise reason presented on a relevant EU primary source of law (mostly treaties and directives), while a restrictive measure may be justified under certain circumstances of general public interest which are reflected by the CJEU's 'Rule of Reason'. The CJEU does not make this distinction very clear, and usually uses the restriction method in direct taxation cases. Consequently, a tax measure might construed as restrictive when it creates a minor obstacle to the freedom of movement or establishment inside the EU, even if that measure does not treat differently different people in similar conditions.[41] In the event that a certain tax measure is considered restrictive, the CJEU decides whether it can be justified by a reason recognized by the general public interest. The justifications approved by the CJEU are considered as the court's 'Rule of Reason'. Over the years, the CJEU accepted the need to confront tax avoidance as a part of its 'Rule of Reason' as a justification for restrictive measures in several cases, and developed a community concept of tax avoidance through a case-by-case method.[42]

The CJEU's approach to the justification of confronting tax avoidance to eliminate restrictive measures was patchy, and it is hard to follow a coherent legal doctrine used by the court on that issue. In early cases the CJEU was more reluctant regarding the tax avoidance justification. For example, in Avoir Fiscal, France restricted the freedom of establishment by refusing to attach imputation credit to dividends paid to

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[37] See: Case 125/76 Firma Peter Cremer v. Bundesanstalt fur landwirtschaftliche Marktorndnung, [1977] ECR 1593, paragraph 21. Case C-8/92 General Milk Products GmbH v. Hauptzollamt Hamburg-Jonas, [1993] ECR I-779 paragraph 21.
[38] Case C-212/97 Centros Ltd v. Erhvervs-og Selskabsstyrelsen, [1999] ECR I-1484, paragraphs 24-25. (Hereinafter: **"Centros"**).
[39] Case C-110/99 Emsland-Starke GmbH v. Hauptzollamt Hamburg-Jonas, [2000] ECR I-11595. (Hereinafter: **"Emsland-Starke"**).
[40] Emsland-Starke, Paragraph 39.
[41] Almendral, p.572.
[42] Almendral, p.569-570.

French branches of non-resident insurance companies as it permits regarding branches of resident insurance companies. The court refused to accept the French claim that its refusal relies on the risk of tax avoidance since it was not one of the known permissible justifications for restriction on the freedom of establishment.[43]

It was only a few years later that the court came to understand the harmful outcome of cross-border tax abuse and accepted tax avoidance as a justification that is included in the CJEU 'Rule of Reason' and enables MSs to apply certain restrictive measures. At first, the tax avoidance justification was permitted only under conditions of strict proportionality requirement, requiring that the measure directly confront only 'wholly artificial arrangements',[44] without providing clear definition to that term. It was concluded that the mere possibility that a taxpayer achieves an advantage not intended to be granted to him by the relevant legislation does not suffice to use the tax avoidance justification without proof of clear abusive action. Following the CJEU's strict approach regarding the justification of tax avoidance, it was decided that tax advantages provided by the mere establishment in 'low tax jurisdictions' cannot justify a less favorable tax treatment given by another MS, and there needs to be an artificial profit shifting.[45]

There are a number of factors that the court used in deciding on using the tax avoidance justification. First and foremost, the criterion of the proportionality of the relevant measure to its purposed objective and the requirement that the restriction not go beyond what is necessary in order to attain it.[46] A good example of the importance of the proportionality principle can be found in the landmark case of National Grid Indus[47]. There, the court concluded that the immediate payment request of 'exit taxes' is forbidden within the EU. It decided that the sanction of immediate payment of taxes in case of emigration within the EU is discriminative (since domestic transfers do not require any payment), not proportionate, and radically harmful to the free movement of people and capital and to the freedom of establishment.[48] Such a measure cannot be justified by the need to prevent tax avoidance, since the transfer of legal seat in itself cannot prove the existence of tax abuse.[49] MSs must give emigrating taxpayers the choice between paying capital gains tax upon emigration, or delaying the payment with guarantees and further administrative

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[43] Avoir Fiscal, paragraph 25.

[44]See: Case C-264/96 Imperial Chemical Industries plc (ICI) v. Her Majesty's Inspector of Taxes, [1998] ECR I-4711, paragraph 26. (Hereinafter: **"ICI"**). Case C-324/00 Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt, [2002] ECR I-11802, paragraph 37. (Hereinafter: **"Lankhorst"**).

[45] Case C-297/97 Eurowings Luftverkehrs v. Finanzamt Dortmund-Unna, [1999] ECR I-7463, paragraph 45. (Hereinafter: **"Eurowings"**).

[46] Centros, paragraph 34.

[47] Case C-371/10 National Grid Indus BV v. Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam, [2011] ECR I-12307. (Hereinafter: **"National Grid Indus"**).

[48] National Grid Indus, paragraph 41.

[49] National Grid Indus, paragraph 84.

burden placed on the taxpayer. Such a measure was considered as restrictive to the freedom of establishment in a proportionate manner and not beyond what is necessary. However, it was not justified by the need to prevent tax avoidance but by the need to ensure the balanced allocation of taxing powers between MSs.[50]

Every anti-avoidance measure is envisaged and interpreted in accordance with the EU law that applied it (usually directives). If the relevant directive contained an anti-avoidance provision, the court created a unique tax avoidance concept for the purpose of that directive. In those cases the court usually interpreted the anti-avoidance clause in a narrow fashion, limiting the range of freedom given to MSs and refusing to approve an abolition of benefits which are the purpose of the relevant directive because of the risk of tax avoidance.[51] In the absent of a defined concept of tax avoidance in the EU, the CJEU's role was to provide general guidance for national courts in deciding on cases of infringement of community law by tax measures. Any national anti-tax-avoidance provision must be done in the light of EU law,[52] meaning it must be sufficiently clear and precise to provide legal certainty, and designed to exclude tax advantages only when purely artificial arrangements exists.

This vague approach was eliminated by the CJEU in two landmark decisions that were given in 2006 – Halifax (on indirect taxation) and Cadbury Schweppes. In those cases the court gave a coherent material approach that can be aggregated into solid principles that creates a basis for a new community tax avoidance concept. The ATAD that was approved more than a decade later is directly connected to those decisions, reflecting the main role assumed by CJEU in the harmonization of laws within the community, particularly in such a problematic subject as direct taxation where the fear of MSs of waiving their sovereignty is extremely high. In the next sub-parts I will analyze those two decisions and their reflection on later direct taxation cases brought to the CJEU.

2.2.3. The Halifax case

Halifax is a VAT case, but the decision in this case had a direct impact on the un-harmonized field of direct taxation. Halifax is a banking company that the vast majority of its supplies are VAT exempt financial services. The bank engaged in several artificial properties development projects involving different companies of the bank's group in order to recover input VAT that it would otherwise have been unable to recover due to its exempted transactions.[53] The bank was strictly entitled to deduct the input

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[50] National Grid Indus, paragraph 73.

[51] Joined Cases C-283/84, C-291/94 and C-292/94 Denkavit Internationaal BV v. Bundesamt fur Finanzen, [1996] ECR I-5085, paragraph 19.

[52] Centros, paragraphs 24-25.

[53] Halifax, paragraphs 12-29.

VAT under consideration as followed from Article 17 of The Sixth Directive. The UK government claimed that it can refuse the deduction of input VAT following the 'principle of abuse of rights' as derived from the CJEU case law.[54] This case came to the VAT and Duties Tribunal in London, which stayed the proceedings and referred the following question to the CJEU[55]: *"Does the doctrine of abuse of rights as developed by the Court operate to disallow the appellants their claims for recovery of or relief for input tax arising from the implementation of the relevant transactions?"*

The CJEU repeated its ruling in commercial law issues whereby the application of community legislation cannot cover abusive practices with the sole purpose of wrongfully obtaining advantages provided by it, and extended this doctrine to the sphere of VAT.[56] The court continued in reviewing its previous rulings on tax issues, emphasizing the objective of preventing tax avoidance or abuse encouraged by The Sixth Directive on one hand, and the requirement for legal certainty in issues which entails economic consequences and the right of a trader to choose the way he conduct his transactions on the other.[57]

After considering the conflicted motives, the CJEU applied a general anti-abuse concept that is formulated as a general principle of prohibiting abusive practices. The court applied for VAT cases a similar version of the two fold test it used in Emsland-Starke regarding the proportionality requirement needed for the justification of tax avoidance. Although the CJEU was referring to the already harmonized VAT sphere only, it used general terms that allowed an application of that concept in the field of direct taxation too.[58] Following the Halifax's concept of tax avoidance, an abusive practice that justifies a restriction on tax benefits provided by EU law can be found to exist only if: (1). the transactions concerned result in the accrual of a tax advantage contrary to the purpose of the provisions providing that advantage (objective test).[59] (2). it must be apparent from a number of objective factors that the essential aim of the transactions is to obtain tax advantage (subjective test).[60] Regarding the evaluation of the 'essential aim' of transactions, the national courts were led to consider the substance of the transactions, taking into account the artificial nature of thereof.[61]

This two fold test places limits on MSs in the way in which they formulate their tax anti-abuse provisions. Essentially, the test is formulated as a GAAR that contains objective and subjective elements. The

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[54] Halifax, paragraph 63.
[55] Halifax, paragraph 43.
[56] Halifax, paragraphs 69-70.
[57] Halifax, paragraphs 71-73.
[58] Greg Sinfield, *The Halifax Principle as A Universal GAAR for Tax In the EU*, B.T.R. Vol. 3 235, p. 237, 2011. (Hereinafter: **"Sinfield"**).
[59] Halifax, paragraph 74.
[60] Halifax, paragraph 75.
[61] Halifax, paragraph 81.

objective element requires that the tax advantage was achieved in contrary to the purpose of the relevant community law provisions. In Halifax it was concluded that the deduction of input VAT requires a direct link to a particular output transaction, which secures the principle of fiscal neutrality. The transactions under consideration were made with the aim of deducting an originally exempted input VAT in order to achieve a tax advantage, hence it contradicted the purpose of the Sixth Directive.[62]

The subjective element requires the activity under consideration to be taken under the essential aim of tax avoidance, taking into account the artificial nature of the transactions. In a later VAT case the court gave a brighter definition to the term ‘essential aim’, clarifying that it does not mean the sole aim. If the most important purpose of the transactions is tax avoidance, an existence of other ancillary business purposes should not protect the abusive behavior.[63]

The real innovation of the Halifax decision is the application of the general EU doctrine of abuse on the VAT sphere and on other tax directives which contained an anti-abuse provision as the Mergers Directive and the Parent-Subsidiary Directive.[64] The judgment in Halifax was not clear regarding the application of the concept of tax avoidance through the non-harmonized areas of direct taxation. It was settled that MSs are competent to design their tax system in the non-harmonized areas of direct taxation, and that they must exercise that competence consistently with EU law. The justification of tax avoidance was already approved by the CJEU in direct taxation cases, but its scope was narrower, targeting only ‘purely artificial arrangements’ and requiring a clear proof of abusive behavior. The application of the EU concept of tax avoidance on direct tax issues happened later on the same year, with a slightly different approach that will be discussed at the next sub-part.

2.2.4. The Cadbury Schweppes case

At first glance, it seems as though Halifax and Cadbury Schweppes deal with unrelated issues. First, the Halifax case was a pure VAT case, while the Cadbury Schweppes case concerned a cross-border corporate tax issue. Second, in the Halifax case the UK tax authority claimed abuse of EU law since it had no proper national anti-avoidance provision to confront the abusive behavior taken by the bank. In Cadbury Schweppes, a national anti-avoidance provision had already been applied, and it was the taxpayer (hereinafter: **“Cadbury”**) who appealed to the CJEU, claiming that this provision breached his freedom of establishment in an unproportioned matter. Eventually, the test that the CJEU applied in both

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[62] Halifax, Paragraphs 79-80.

[63] Case C-425/06 Ministero dell’Economia e delle Finanze v. Part Service SRL, [2008] ECR I-00897, paragraph 62. (Hereinafter: **“Part Service”**).

[64] Sjoerd Douma & Frank Engelen, *Halifax Plc v Customs and Excise Commissioners: The ECJ Applies The Abuse of Rights Doctrine in VAT Cases*, B.T.R Vol. 4 429, p. 437, 2006.

cases and its approach of preferring substance over form points to the resemblance of the concepts applied.

The decision in Cadbury Schweppes is an extension of the abuse of law doctrine that was provided in Halifax to the non-harmonized areas of direct taxation.[65] The CJEU concluded that the abuse of rights doctrine applies disregarding whether the abusive practice circumvallate an EU law or national law.[66] The outcome of both decisions is an EU anti-abuse principle which set boundaries on MSs when they restrict EU nationals' fundamental freedoms in order to confront tax avoidance.

Cadbury was a company registered in the UK which controlled subsidiaries in other MSs and in third states. The UK tax authority concerned the taxation of the company in respect of profits made in 1996 by its subsidiary in Ireland. The UK tax authority impose income tax on resident companies' worldwide income, but gives tax credit up to the amount of tax which was paid by the foreign subsidiary. The SAAR under consideration was the UK domestic controlled foreign company rules (Hereinafter: **"UK CFC rules"**). In a nutshell, the UK CFC rules were designed to tackle UK companies which try to avoid the high corporate tax rates in the UK by shifting profits into foreign subsidiaries which located in 'low tax jurisdictions'. If a foreign subsidiary is considered as a CFC, its profits are attributed to its UK resident controlling company on a pro-rata basis, and taxed in the later hands at the moment the profit arises. The UK CFC rules applies when the foreign subsidiary is subject to 'lower level of taxation' in its residence state, means less than three quarters of the amount of tax which would have been paid in the UK on same periods. There were exceptions to the application of the UK CFC rules, if the foreign company had an acceptable distribution policy, was engaged in exempted activities, or made only small amount of profits.[67] The UK Commissioner applied the UK CFC rules on the Irish subsidiary of Cadbury and taxed its profits in the hand of Cadbury disregarding the separate legal identity of the two companies. The taxpayer claimed that the UK CFC rules breach his freedom of establishment, hence contradicting EU law.

The national court of the UK faced uncertainties as to the application of EU law to the case. Essentially, the UK court asked the CJEU three main questions:[68] (1). Does establishing an entity in another MS in the sole purpose of taking advantage of a favorable tax regime constitutes abuse of the freedom of establishment by the taxpayer? (2). If the taxpayer is merely exercising the freedom of establishment in a unique matter that is not completely abusive, does the UK CFC rules amounts to restriction in the

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[65] Sinfield, p. 240-241.
[66] Terra & Wattel, P. 481.
[67] Cadbury Schweppes, paragraphs 13-21.
[68] Cadbury Schweppes, paragraphs 23-27.

exercise of the right of establishment or discrimination? (3). could the UK justify the breach on the grounds of preventing tax avoidance?

As for the first question there was a very little doubt since previous case law already concluded that the purpose of benefiting from favorable tax regime does not constitute in itself an abuse of the freedom of establishment. The abusive practice must have some fraudulent features, so mere tax avoidance is not enough to constitute it.[69] Hence, the fact that the taxpayer registered its subsidiary in Ireland with the purpose of benefiting from the low corporation tax rates there does not constitute an abuse of EU law by itself.

After establishing that the taxpayer did not abuse his freedom of establishment, the court examined the restrictive elements of the UK CFC rules. The freedom of establishment has an aim to ensure that foreign EU nationals will receive the same tax treatment as the residents of the relevant MS.[70] The UK CFC rules treated differently foreign subsidiaries that incorporated in different tax level jurisdiction. This disadvantage is considered as a restriction on the freedom of establishment that needs to be justified by overriding reasons of public interest and to not go beyond what is necessary.[71] It was known already that the reduction of national tax revenue is not a sufficient justification and the discussion was on the justification of confronting tax avoidance.

The UK government together with other Six MSs claimed that the UK CFC rules are intended to confront a specific type of tax planning involving the artificially shifting of profits to low tax jurisdictions.[72] The CJEU concluded that for a restriction on the freedom of establishment to be justified on the ground of abusive practices it most confront only 'wholly artificial arrangements' which do not reflect economic reality, basically repeating the artificial requirements from the subjective test set out on the Halifax case.[73] The real innovation of the Cadbury Schweppes case was regarding the decision whether the UK CFC rules restricts the freedom of establishment in a proportionate manner and not beyond what is necessary to confront tax avoidance. The CJEU precisely defined what should be considered as 'abuse of law' and the limits relied on MSs when they apply measures to confront it. The court uses the two fold test from Halifax, only here instead of relying on the interpretation of The Sixth Directive which reflects an already

[69] Cadbury Schweppes, paragraphs 36-37.
[70] Cadbury Schweppes, paragraph 42.
[71] Cadbury Schweppes, paragraphs 46-47.
[72] Cadbury Schweppes, paragraph 48.
[73] Cadbury Schweppes, paragraph 55.

harmonized field, it rely on the interpretation of the freedom of establishment itself, hence its application is formally much wider.[74]

The CJEU basically repeated the test provided at Halifax with few small changes. The subjective test requires, as in Halifax, an intention to obtain tax advantage, but instead the term *"essential purpose"* the court used a broader term - *"main or one of the main purposes"*. This difference is not just literal, since even if the terms 'essential' and 'maim' would not lead to a different scope of application of the provision, the notion 'one of the main purposes' is clearly much wider than the notion 'essential purpose'. The practical meaning of this difference is a broader range of situations in which restrictions on EU fundamental freedoms may be justified by the need to confront tax avoidance. The court continues and determines that the existence of tax motives should not construct an abuse if the targeted arrangements reflect economic reality and are genuine.[75] The taxpayer must be given an opportunity to prove that its activities are genuine.[76]

The objective test requires that the targeted arrangements are not achieving the objective pursued by the EU source of law that Cadbury was relaying on, the freedom of establishment. The court gave substantial interpretation to the freedom of establishment and concluded that its purpose is to foster economic activities. Hence, the targeted economic activity must go against that purpose, meaning to not reflect any economic reality.[77] This formula in which the CJEU examine if a domestic tax avoidance rule complies with EU law was repeated and sharped in following direct taxation cases, and eventually became a formal concept of tax avoidance in the EU.

2.2.5. The Thin Cap case and the formal application of the concept of tax avoidance

Half a year after the CJEU gave its innovative judgement in Cadbury Schweppes, it dealt with another case (Thin Cap) in which taxpayers claimed for infringement of their freedom of establishment by a national SAAR. This time, the CJEU dealt with the restrictive nature of the UK thin capitalization rules. In a nutshell, at certain conditions the UK restricted the ability of UK resident companies to deduct from their taxable income interest payments on financing loans granted directly or indirectly by a parent company resident in another MS. Instead, that payment was reclassified as a non-deductible distribution.

[74] Prof. Frans Vanistendael, *Halifax and Cadbury Schweppes: One Single European Theory of Abuse in Tax Law?* EC Tax Review Vol.4 192, p. 194, 2006.
[75] Cadbury Schweppes, Paragraphs 65-66.
[76] Cadbury Schweppes, Paragraph 70.
[77] Philip Simpson, *Cadbury Schweppes Plc v Commissioners of Inland Revenue: The ECJ Sets Strict Test For CFC Legislation*, B.T.R Vol. 6 677, p. 681, 2006.

The claim was that the UK thin capitalization rules (that were amended few times) were treating companies with non-resident parent lender less advantageous than companies with UK resident lender.

The court concluded that the UK thin capitalization rules treated taxpayers differently on the basis of the place of establishment of its lending parent company through all the versions of those rules until 2004. Since that difference in treatment makes it less attractive for companies established in MSs other than the UK to exercise their freedom of establishment in the UK by financing local subsidiaries thorough loans, it constitutes a restriction on this freedom. Such a restriction is only permissible if it can be justified by overriding reasons of public interest.[78] The UK government argued that the restriction under consideration is justified by both the need to ensure the cohesion of the tax system and the need to confront tax avoidance.

After refusing to accept the justification on the basis of the need to ensure the cohesion of the tax system, the court addressed the tax avoidance justification. The UK thin capitalization rules caught as targeting a specific abusive practice involving group of companies which seek to reduce the taxes imposed on one of their members by allowing it to transfer profits as interest expenditure. If the lender is subject to lower corporate tax rate the group as a whole pays less taxes. By treating that interest payment as distribution this abusive practice can be prevented.[79] The problem was that the UK thin capitalization rules did not exactly aimed only at 'wholly artificial arrangements', and was applied in place where the loan was not given in an arm's length conditions, disregarding the artificial nature of the economic operations. The court looked for a solution that will enable MSs to confront this purely abusive practice and be justified in terms of proportionality as set in Cadbury Schweppes.

Eventually, the court loosed the strict artificially requirement as concluded in Cadbury Schweppes by representing an alternative way to fulfill it. It was concluded that the fact that a loan was given between related parties which situated in different MSs in terms which deviate from arm's length conditions is suffice by itself to fulfil the artificial requirement in order to justify a restriction on the freedom of establishment.[80] Such a restriction will be considered proportionate in two conditions: (1). only the proportionate part in which the actual interest rate exceeded the arm's length interest rate will be reclassified as a distribution. (2). the taxpayer was given the opportunity to provide evidence of any commercial justification for the loan agreement.[81] In assent, after the initial broadening of the scope of the tax avoidance justification in Cadbury Schweppes, now the court expands it again through the

[78] Thin Cap, paragraph 63.
[79] Thin Cap, paragraphs 76-77.
[80] Thin Cap, paragraph 81.
[81] Thin Cap, paragraph 82-83.

acceptance of anti-avoidance measures which do not target only 'wholly artificial arrangements'. In order for this expansion to fulfil the proportionality requirements, the court ensure that the taxpayer will have his opportunity to show the legitimacy of his actions. In previous cases it was the tax authority responsibility to prove the existence of 'wholly artificial arrangements', now it is used as a defensive claim provided by the taxpayer.[82]

This series of case law was summarized by the EU Commission in a special communication delivered in 2007 to ensure the correct approach MSs should take regarding the use of anti-avoidance measures in compliance with EU law.[83] The principles and guidelines concluded in that communication can be seen as a formal application of the concept of tax avoidance, and a first step towards harmonization of anti-avoidance measures in the field of direct taxation.

2.2.6. Conclusion

The CJEU case law on the community concept of tax avoidance constructed the basis on which the current processes of harmonization in the field of direct taxation rely on. Specifically, as will be demonstrated in further parts of this Chapter, the GAAR provided by the ATAD reflects the CJEU decisions regarding the conflict between the need to confront tax avoidance to the obligation of MSs to comply with EU law. On that regard, the objective and subjective tests as concluded in Cadbury Schweppes are of the same nature as eventually formulated in the GAAR provided by the ATAD. In addition, the substance over form approach as concluded in Thin Cap is reflected through terms such as 'valid commercial reasons' and 'economic reality' which were included in the GAAR provided by the ATAD on expanse of the term 'wholly artificial arrangements' that was used in Cadbury Schweppes.

In order to evaluate the effectiveness of the GAAR provided by the ATAD it was necessary to understand the considerations taken while choosing this type of GAAR. The compliance with EU law and especially with the four fundamental freedoms inflicts obstacles on MSs to confront certain types of tax avoidance. The GAAR and SAARs provided by the ATAD are designated to comply with EU law as well, hence they target only part of the arrangements consisting tax avoidance. Those constrains should be taken into account when evaluating the effectiveness of the GAAR provided by the ATAD in comparison to the PPT rule provided Action 6 which is based on a different concept of tax avoidance.

[82] Terra & Wattel, p. 487.

[83] Commission Communication to The Council, The European Parliament and The European Economic and Social Committee on Application of Anti-Abuse Measures in The Area of Direct Taxation – Within the EU and in Relation to Third Countries, 2007 O.J. C 785, 10.12.2007. (Hereinafter: **"Communication 2007"**).

2.3. The reasons for applying the ATAD

After establishing the legal framework on which the GAAR provided by the ATAD is based, this sub part is devoted to understanding the political and economic atmosphere that led to adoption of the ATAD.

2.3.1. The EU Commission's agenda for corporate taxation in the community

When looking at the discussion papers on international taxation taken by the EU Commission before the adoption of the Anti-Tax Avoidance Package (hereinafter: **"ATA Package"**) and by the OECD before publishing the BEPS Project final reports, it is possible to observe that the same threats were marked. The worldwide economy environment has become more globalized, mobile and complexed. In parallel, the generally accepted international rules on splitting income between states in cross-border operations had not developed accordingly.[84] At the times when the generally accepted international taxation rules were adopted, most MNEs were large industrial companies with relatively simple business models in which each stage of the production process was devoted to a separate subsidiary. Hence, it was easy to decide which country should tax a certain profit. The arm's length principle promised that intra-group transactions will be taxed according to comparable market prices, providing for a sufficient allocation of profits between members of a group of companies.[85]

The developments in the worldwide economic environment enabled MNEs to shift profits to the lowest possible tax jurisdiction and minimize their overall tax burden. The globalization made it easier for MNEs to engage in large number of markets and to use the differences between tax systems to their benefit. The transition from the old economy which was based on heavy industry to a mobilized economy provided MNEs the opportunity to locate yielding assets in jurisdictions with low corporate tax rates. Countries play a double role regarding the taxation of MNEs. There is a strong public demand to impose higher taxes on MNEs in order to create a fairer allocation of the tax burden according to the ability to pay principle. In contrast, the vast majority of countries provide special tax benefits for MNEs in order to attract them to invest in their territory. The outcome of this tax competition is a constant erosion of the tax burden imposed on MNEs.[86] Eventually, the loss of revenues from taxes and the disadvantage to local businesses caused by aggressive tax planning taken by MNEs led countries to confront it in a cooperative manner.

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[84] BEPS Project explanatory statement, p. 4-5.

[85] Commission Communication to The European Parliament and The Council on A Fair and Efficient Corporate Tax System in The European Union: 5 Key Areas For Action, 2015 O.J. C 302, p. 2-3, 17.6.2015.(Hereinafter: **"Communication 2015"**).

[86] Communication 2015, p. 4-5.

Soon after the OECD published the final reports of the BEPS Project in October 2015, MSs have denounced that they intend to implement new measures against aggressive tax planning as soon as possible. Uncoordinated implementation of the BEPS Project recommendation by MSs would create new opportunities for tax planners to use differences in their advantage. This risk is more harmful in the context of the single market, where the laws of one MS affects the effectiveness of the laws of another MS. In addition, a common approach taken by MSs is important due to their obligation to comply with EU law in general and with the CJEU case law on the concept of tax avoidance in specific.[87] Therefore, the EU Commission took a quick action and published a proposal for a package of measures and guidelines that together with the CCCTB proposal[88] represents a new approach of corporate taxation in the EU (the ATA Package).

This new agenda of the EU Commission has four main objectives[89]: To establish a link between taxation and the place where the economic activity actually takes place, to ensure more reliable valuations of corporate activity in MSs jurisdictions, to create a growth-friendly corporate tax environment, and to increase tax transparency in order to protect the internal market. Theoretically, the adoption of the CCCTB, which is in line with the agenda taken by the OECD through the BEPS Project,[90] could prevent by itself the vast majority of aggressive tax planning within the EU. However, the lack of agreement on the CCCTB formulation and the uncertainty regarding its outcome brought the EU Commission to propose the more pragmatic ATA Package first.[91]

2.3.2 The role of the ATAD in the ATA Package

The ATA Package consists of several EU sources of law of which the ATAD is the most binding one. As usual, disagreements between MSs regarding unified rules in the field of direct taxation prevented the full harmonization of tax anti-abuse measures through the ATA Package. The ATAD reflects the areas in which MSs could achieve certain degree of agreement on, albeit a lot of leeway left as a consequence of the minimum standard approach taken there. In areas where MSs refused to give up on any degree of

[87] Commission Communication to The European Parliament and The Council on Anti-Tax Avoidance Package: Next Steps Towards Delivering Effective Taxation and Greater Tax Transparency in The EU, 2016 O.J. C 23, p. 3-4, 28.1.2016. (Hereinafter: **"Communication 2016"**).
[88] Council Proposal for a Directive on a Common Consolidated Corporate Tax Base (CCCTB), 2016 O.J. C 683, 25.10.2016. (Hereinafter: **"CCCTB"**).
[89] Communication 2015, p. 6.
[90] Communication 2016, p. 3.
[91] Communication 2016, p. 8.

sovereignty, the Commission provided communications consisting of guidelines and recommendations regarding the implementation of the relevant BEPS Project recommendations.[92]

One of the issues MSs refused to harmonize was the issue of tax treaties. That refusal worried the EU Commission, especially due to the recommendations given in Action 6 of the BEPS Project regarding measures against treaty abuse. Action 6 consists of several LOB provisions and a PPT rule which their compatibility with EU law is questionable (on the compatibility of the PPT rule with EU law, see sub-par 4.2.2). Hence, the ATA Package include a specific recommendation on that issue that supposed to guide MSs towards the implementation of anti-abuse measures in their tax treaties with other MSs and with third states, and gives unified definition of a PE status for treaty purposes.[93] However, these recommendations considered as 'soft law', not binding MSs and therefore not sufficient to ensure a coordinated implementation of the measures through the EU.

The ATA Package includes a recommendation towards the unified approach should to be taken towards third countries on tax matters. This recommendation provides criteria for 'good governance' regarding MS's external policy on tax matters and a list of countries which are suspect as tax havens.[94] The implementation in the EU level of the country-by-country reporting which was provided by the BEPS Project in its Action 13 was coordinated through a revision proposal of the Administrative Cooperation Directive.[95] The revision provide for new transparency provisions that should allow MSs the access for information they need in order to detect aggressive tax planning taken by MNEs.

The ATAD is the heart of the ATA Package, containing rules that directly tackle several tax avoidance practices which are caught as the most harmful practices to the internal market.[96] It is the tool selected by the EU Commission to ensure that the implementation of the BEPS Project recommendations among MSs will take place in a unitary way. Practically, the Commission walked only half way regarding the harmonization of tax anti-avoidance measures, and set up rules on issues that already dealt by the CJEU. In essence, the ATAD aim to provide a common approach regarding some leading anti-abuse measures, enabling MSs to take domestic considerations into account. The ATAD provide six legally binding anti-abuse measures: interest limitation rule, exit taxation, switch over clause, GAAR, CFC rules and hybrid

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[92] Communication 2016, p. 6.
[93] Commission Recommendation to Member States on The Implementation of Measures Against Tax Treaty Abuse, 2016 O.J. C 271, 28.1.2016. (Hereinafter: **"Commission's Treaty Recommendation"**).
[94] Commission Communication to The European Parliament and The Council on An External Strategy for Effective Taxation, 2016 O.J. C 24, 28.1.2016.
[95] Council Proposal for Amending Directive 2011/16/EU As Regards Mandatory Automatic Exchange of Information in The Field of Taxation, 2016 O.J. C 26, 28.1.2016.
[96] ATAD Proposal, p. 1-2.

mismatches arrangements. MSs are obliged to ensure the level of protection provided by the ATAD, and aloud to apply more restrictive rules, as long as these rule are in line with EU law.[97]

In summarize, the ATAD provide for minimum standard approach on issues that have been discussed broadly in the CJEU case law and are generally accepted among MSs. In that regard, the application of the ATAD is only a unified summarization of the CJEU case law on tax avoidance, hence no extra sovereignty was absorbed from MSs on direct tax issues. However, the importance of the ATAD is connected to the publication of the BEPS Project recommendations since, especially in case of the EU and its internal market, it is important to reduce un-coordinated implementation of anti-avoidance measures among the MSs as much as possible.

2.4. An overview of the GAAR provided by the ATAD

2.4.1. The role of the GAAR in the ATAD

As mentioned in sub-par 2.3.2, the ATAD is broadly divided to six different issues, all together combined into a legal framework that should provide the minimum protection required for MSs to confront tax avoidance. The GAAR provided by Article 6 of the ATAD meant to be used as an overall tool that tackles artificial arrangements in situations that are not covered by another SAAR provided by the ATAD. In essence, the GAAR provided by the ATAD, like any other national GAAR, acts as a gap filling provision, being important tool for tackling sophisticated planning schemes that regularly occurs shortly after the legislation of a SAAR.[98] As such, its application does not affect the application of the SAARs provided by the ATAD. The GAAR provided by the ATAD is the first attempt to formulate a unitary GAAR in the EU level, ensuring the application of the standards provided by the CJEU case law in all the legislative levels of the EU, including domestic law, tax treaties with other MSs and tax treaties with third states.[99]

2.4.2. The formation of the GAAR provided by the ATAD

Although the CJEU case law by could be considered as a unitary European GAAR by itself, the EU Commission changed her mind several times regarding the final formulation of the GAAR provided by the ATAD. Before the negotiations towards the GAAR that would be provided by the ATAD even began, the EU Commission already provided for a GAAR in the field of direct taxation which reflect the CJEU

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[97] ATAD, Article 3.

[98] The European Commission – Fact Sheet: The Anti-Tax Avoidance Package – Questions and Answers, question 10. Can be found on: Europa.eu/rapid/press-release_MEMO-16-160_en.htm.

[99] ATAD, Preface Art. 11.

case law on tax avoidance. The amended Article 1(2) of the Parent-Subsidiary Directive[100] provides the following rule:

"Member States shall not grant the benefits of this directive to 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 this directive, are not genuine having regard to all relevant facts and circumstances".

Article 1(3) of the PSD provides guidance for the interpretation of the term *"non-genuine arrangements"*, linking it to *"valid economic reasons"* and *"economic reality"*. The GAAR provided by the PSD generally reflects the formation settled in the CJEU case law: a subjective element (*"one of the main purpose of obtaining a tax advantage"*), an objective element (*"defeats the object or purpose of this directive"*), and the artificial requirement which is connected to the subjective element (*"not genuine having regard to all relevant facts"* and the guidance provided by Article 1(3) of the PSD).

One would expect that the GAAR provided by the ATAD should take the same form as the GAAR provided by the PSD with the necessary changes. It has to bear in mind that the PSD provide for a certain benefit (exemption of withholding taxes on dividends), while the ATAD does not provide for any benefit but the opposite, it confront certain economic activities which considered abusing. Moreover, the GAAR provided by the PSD has much narrower scope, aiming at denying the specific benefit provided by the directive, while the ATAD has a general effect on MSs domestic tax law.[101] The GAAR provided by the ATAD does not aim at denying benefits, it gives permission to the relevant MS to calculate the tax liability of the taxpayer disregarding the targeted arrangement, as necessary due to the different aim of the ATAD.

But this was not the only difference between the GAAR provided by the PSD to the GAAR initially provided by the ATAD proposal, the subjective element changed too. The subjective element of the GAAR provided by the PSD requires the targeted arrangement to be taken with the *"main or one of the main purpose of obtaining a tax advantage"*. The same words used by the CJEU regarding the subjective element in the Cadbury Schweppes case.[102] Surprisingly, the GAAR initially provided by the ATAD

[100]Directive 2015/121 of the council amending Directive 2011/96/EU on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States, 2015 O.J. L 21/1, 28.1.2015. (Hereiafter: **"PSD"**).

[101] Aloys Rigaut, *Anti-Tax Avoidance Directive (2016/1164): New EU Policy Horizons*, European Taxation IBFD 497, p. 503, November 2016. (Hereiafter: **"Rigaut"**).

[102] Cadbury Schweppes, paragraph 62.

proposal set the subjective element differently, requiring the targeted arrangement to be taken with the *"essential purpose of obtaining tax advantage"*,[103] similarly to the words used in VAT cases such as Halifax,[104] Part Service,[105] and in the Commission's recommendation on aggressive tax planning from 2012.[106]

In Part Service, the CJEU elaborated on the term 'essential aim', concluding that it refers to transactions that essentially seek to obtain a tax advantage as it appears from number of objective factors. Anyhow, it does not mean that the aim of obtaining a tax advantage should be the sole aim of the targeted arrangements in order for the subjective element to fulfil.[107] Hence, there is no real difference between the terms 'essential purpose' and 'main purpose' since if an arrangement has a 'main' purpose it means that at least one more purpose can be found and not precluding the subjective element of being fulfilled. However, a meaningful difference exists between the term 'essential aim' and the second alternative of the subjective element found in the Cadbury Schweppes case and in the GAAR provided by the PSD. This alternative requires that only 'one of the main purposes' will be the purpose of obtaining a tax benefit in order for the subjective element to fulfil. The notion 'one of the main purposes' means that even if a certain arrangement had an equivalent business and tax purposes, the existence of the legitimate business purpose would not preclude the fulfilment of the subjective test. The consequence is that the subjective test provided by Cadbury Schweppes and was adopted through the PSD is wider than the subjective test initially provided by the ATAD.

The choice of the EU Commission in that regard has changed considerably due to the publication of the BEPS Project final reports few months before the publication of the ATAD proposal. The PPT Rule provided by Action 6 of the BEPS Project used the concept of *"principal or one of the principal purposes"* in its subjective element, similarly to the standard provided in Cadbury Schweppes and adopted by the PSD. This fact certainly affected the EU commission that in its final proposal of the ATAD elected the broader concept with the purpose, among others, of reducing coordination obstacles with the BEPS Project as much as possible.[108] The final version of the GAAR provided by Article 6 of the ATAD is written as follows:

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[103] ATAD Proposal, Article 7.
[104] Halifax, paragraph 75.
[105] Part Service, paragraph 27.
[106] Commission Recommendation to Member States on Aggressive Tax Planning, 2012 O.J. C 8806, Article 4.2, 6.12.2012. (Hereinafter: **"Commission Recommendation 2012"**).
[107] Part Service, paragraphs 40-45.
[108] Rigaut, p. 502.

"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.

2. 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."

Essentially, the GAAR provided by the ATAD is a copy of the GAAR provided by the PSD, with the differences of the sanction provided by each rule (denial of benefits and recalculation of tax liability) and its scope. The 'De Minimis' approach taken by the ATAD has a clear impact on this provision, leaving MSs the freedom to decide how to calculate the tax liability in case of application of the provision. The actual meaning of this approach is that the EU Commission imposes a general obligation on MSs to confront abusive behaviors, while the CJEU case law only gave its permission for MSs to take actions against it in accordance with EU law.[109]

2.4.3. The scope of the GAAR provided by the ATAD

It was clear from the CJEU case law that MSs are bound to the formula concluded by the court (objective element, subjective element, artificial requirement) only in regard to internal market situations. The freedom of establishment which prohibits MSs to treat nationals of another MS less favorably than their own nationals does not apply towards nationals of third states. Hence, MSs had complete sovereignty in determine anti-avoidance measures towards nationals of third states, with the exception of group of companies which includes an EU entity.[110] In that regard, not only the GAAR provided by the ATAD has a general scope in the field of direct taxation, unlike some GAARs provided by other directives, it also affects MSs relations with thirds states.

In the preamble of the ATAD it was stated that *"It is furthermore important to ensure that the GAARs apply in domestic situations, within the Union and vis-à-vis third countries in a uniform manner, so that their scope and results of application in domestic and cross-border situations do not differ".*[111] Hence, it is clear that MSs should apply only one GAAR that does not differ according to the personal circumstances of the parties involved. However, that does not mean that the MSs are also bound to

[109] A. Navarro, L. Parada & P Schwartz, *The Proposal for an EU Anti-Avoidance Directive: Some Preliminary Thoughts,* EC Tax Review, 25(3), p. 12-13, (2016). (Hereinafter: **"Navarro, Parada and Schwartz"**).
[110] Communication 2007, p. 8-9.
[111] ATAD, Preamble Article 11.

conclude that exact form of GAAR in their tax treaties with third states. In fact, the recommendation given in respect of the application of the PPT Rule in tax treaties just advised MSs to add the artificial requirement to it, and did not required an application of a GAAR in the form provided by the ATAD Proposal (that back than had different subjective element concept, as discussed at sub-par 2.4.2).[112] Consequently, parallel application of both the GAARs under consideration by one MS is still possible, which makes the coordination between the rules crucial.

2.3.4. The terms and elements of the GAAR provided by the ATAD

There are few terms and elements in the GAAR provided by the ATAD that need to be interpreted according to settled EU law in order to understand the actual application and meaning of this provision. First is the term *"arrangement or a series of arrangements"*, which is not defined through the ATAD. In order to understand what the EU Commission meant in the term 'arrangement' it is possible to look at the broad interpretations it suggests to that phrase in its recommendations: *"any transaction, scheme, action, operation"*.[113] Every action may be considered as an arrangement, without any special forms or order.

The objective element's wording is quite clear and had not changed at all in comparison to the CJEU decisions on tax avoidance cases, but its benchmark is different. The objective element requires that the targeted arrangement has a purpose of obtaining a tax advantage that defeats the object or purpose of the applicable tax law. The examination of the CJEU was always in regard to the relevant tax law that the targeted arrangement is aiming to circulate, whether it is a domestic law or EU law. The CJEU evaluation of the purposes of different tax laws can illustrate and guide MSs towards the functioning of the objective element. First, the general purposes of the relevant tax law should be detected (e.g. the neutrality of the VAT system in the community regarding the Sixth Directive in Halifax). Second, the question is does the tax advantage aimed to be achieved by the targeted arrangement meant to be given following the purpose of the relevant tax law. [114]

The exact same formula of objective element is found in the GAAR provided by the PSD, in which the applicable tax law under consideration is the PSD itself and its purposes. The objective element in the GAAR provided by the ATAD clearly refers to MSs national tax legislation. The problem arises since one might claim that national tax legislation's main purpose is merely raising revenues. National courts might conclude that if the purpose of the relevant national tax law is to merely raise revenues, a taxpayer is

[112] Commission's Treaty Recommendation.
[113] Commission Recommendation 2012, Article 4.3.
[114] For example: Cadbury Schweppes, paragraph 64. Halifax, paragraphs 74-75.

obliged to conduct its business in the most burdensome way, making the objective element senseless.[115] However, the CJEU case law on the concept of tax avoidance provided two conclusions that in my opinion preclude a circumventive interpretation that will undermine the functioning of the objective element. First, the CJEU rejected in several cases the reduction of tax revenues as a justification for a restrictive measure.[116] Second, it was held that the mere fact that a certain taxpayer enjoyed a tax advantage cannot constitute an abuse by itself if no abusive element is attached to it.[117] Therefore, an interpretation which determines that the only purpose of tax laws is raising revenue is too far reaching for the EU legal atmosphere. But the preclusion of such an interpretation does not mean that the objective element is so important anyway, especially when the artificial requirement exist. The artificial requirement ensures that the arrangements targeted by the GAAR are only arrangements which do not reflect economic reality. The fact that the tax advantage was obtained due to the participation of the taxpayer in an arrangement that does not reflect economic reality cannot be in line with the purpose of any tax law. In contrast, where the artificial requirement is fulfilled by an action which perceived as artificial, but do reflect economic reality (e.g. payment not in line with the arm's length principle)[118] the importance of the objective element increases. In these situations, the fact that the artificial requirement fulfilled does not necessarily means that the obtaining of tax advantage is not in line with the purpose of the relevant legislation.

The subjective element found in the GAAR provided by the ATAD set a requirement by which the targeted arrangement was *"put in place for the main purpose or one of the main purposes of obtaining a tax advantage"*. The notions 'main purpose' and 'one of the main purposes', as described in sub-par 4.2.2, does not require the tax purpose to be the sole purpose of the arrangement in order for the subjective test to be fulfilled. In fact, it does not even require it to be the only important purpose of the arrangement. The existence of a substantial and legitimate business purpose would not preclude the application of the provision if alongside the business purpose an equally substantial tax purpose is found to exist.

The term 'tax advantage' is not defined through the ATAD. Surprisingly, also the CJEU did not give an interpretation to this term. Apparently, the reason the CJEU have not seen a need to put substance in this term is the obvious tax advantages that were obtained in the case law on tax avoidance. However, unlike GAARs provided by other directives that target certain tax benefits provided by the same directive, the ATAD does not provide for any benefits. In my opinion, in the absent of interpretation to this term it is

[115] Navarro, Parada and Schwartz, p. 15.
[116] See: Lankhorst, paragraph 36. ICI, paragraph 28.
[117] Eurowings, paragraph 42.
[118] Thin Cap, paragraph 81.

possible to use the meaning given to the term 'advantage' in state aid law. Following state aid law, advantage can be found in any form whatsoever.[119] For the purpose of the GAAR provided by the ATAD, any advantage that may result directly or indirectly in lower tax burden should be considered as a 'tax advantage'. This way the same meaning is given to same terms in connected areas, what increases the legal certainty and harmonization process through the EU.

Following the artificial requirement, the targeted arrangement should be considered as *"non-genuine having regard to all relevant fact and circumstances"*. Article 6(2) of the ATAD provides for an explanation saying *"an arrangement will be considered as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality"*. The evaluation of the artificial nature of the arrangement is the main issue in the GAAR provided by the ATAD and it reflects directly the CJEU case law on tax avoidance. The terms 'valid commercial reasons' and 'economic reality' are the exact terms that the CJEU used in its landmark decision of Cadbury Schweppes. Moreover, the use of the term 'non-genuine' instead of the term 'wholly artificial' from Cadbury Schweppes reflects the impact of the decision of the CJEU in Thin Cap. There, the CJEU accepted that deliberate deviation from the arm's length principle in dealing between related parties is suffice for the artificial requirement despite the dealings itself were not 'wholly artificial'. As concluded in Thin Cap, if the taxpayer is able to explain his behavior with economic reasons his actions will remain out of the scope of the provision.

The question of the existence of 'valid economic reasons' which reflects 'economic reality' is rather a question of substance over form. It is based on the evaluation of objective factors like evidences of physical existence and the carry of meaningful economic activity.[120] However, the broad scope of the GAAR provided by the ATAD influences on the degree of unity it requires. The exact definition for 'valid economic reason' and 'economic reality' along with the weight that should be given to facts regarding substantive economic performance were left to be decided individually by each MS.[121] Hence, each MS is able to take into account the specific circumstances of its market and formulate different conditions for the artificial requirement. In its recommendation on aggressive tax planning from 2012, the EU Commission suggested considerations that should be accounted when deciding if a certain arrangement is artificial for the purpose of the EU concept of tax avoidance. Due to the direct link between the GAAR provided by the ATAD and the EU concept of tax avoidance, it is possible to use those Commission suggestions for the purpose of the artificial requirement found in the GAAR.

[119] TFEU, Article 107.
[120] Communication 2007, p. 3-4.
[121] ATAD, Preface, Article 11.

Following the Commission recommendation from 2012, these are the indications that should lead MSs to conclude that a certain arrangement is artificial:[122] some of the parts of the arrangement are not consistent with the legal substance of the arrangement as a whole, the arrangement was taken in a manner that would not have been taken through a reasonable business operation, the arrangement consists of elements which cancels each other, transactions are taken in a circular manner, the tax benefit obtained is not proportional to the business risk taken through the arrangement, and when the tax benefit is significantly higher than the pre-tax profit generated of the arrangement. These tests should not apply strictly in every case, but have the function of accumulative tests that when combined together should provide a clear result regarding the artificiality of the arrangement under consideration.

In conclusion, the GAAR provided by the ATAD can be considered as a unified GAAR in the internal market only for a certain degree. It obliges MSs to adopt a GAAR which reflects directly the CJEU case law on tax avoidance and clarifies the importance of the artificial nature of abuse in the EU context. It also promises that MSs will formulate the same GAAR for domestic and cross-border situations inside the EU. However, it seems like MSs are not entirely bounded to conclude such a provision with third countries through their tax treaties. Moreover, each MS is free to give its own meaning to the terms ‘valid economic reason’ and ‘economic reality’, with the consequence of possible differences among the GAARs finally applied by MSs. In terms of harmonization, the GAAR provided by the ATAD do provide for an EU standard regarding the formulation of domestic GAARs. However, the references to domestic legislation in several places through the GAAR will probably cause some substantial differences among the GAARs which will be adopted by MSs in the near future.

2.5. The effectiveness of the GAAR provided by the ATAD

This sub-part will follow the method to evaluate the effectiveness of rules presented in part 2.4, in which effectiveness of a GAAR is measured using two parameters: the degree of legal certainty that the GAAR under consideration provides, and its ability to confront abusive practices that would otherwise result in revenue loss without hindering free trade.

2.5.1. The GAAR provided by the ATAD and legal certainty

2.5.1.1. The CJEU case law on legal certainty

In two landmark cases upheld in 2012 and 2013, the CJEU provided for a new requirement regarding MSs domestic tax legislation in order for it to be considered as compatible with EU law. According the

[122] Commission Recommendation 2012, Article 4.4.

CJEU, the principle of legal certainty requires tax rules which effect taxpayer's tax liability to be clear, precise, and predictable as regards to their effect, especially when they may have unfavorable consequences for taxpayers.[123]

The first case involved a Belgian legislation by which expanses were non-deductible in certain circumstances. One of those situations was regarding payments made to foreign establishments. Such payments were non-deductible if the receiver was *"subject to a tax regime which is appreciably more advantageous than the applicable tax regime in Belgium".* [124] The CJEU justified the restriction on the freedom to provide services by the need to confront tax avoidance, the need to ensure the effectiveness of fiscal supervision, and the need to preserve the balanced allocation of the power to impose taxes between MSs.[125] However, the legislation did not meet the requirements of the principle of legal certainty and hence could not be considered proportional to the objective pursued. The reason to this decision was that it is not possible to expect from a taxpayer to evaluate the characteristics of his business mate's tax system in order for its payments to be deductible.[126]

The CJEU elaborated on the principle of legal certainty specifically regarding anti-abuse measures in the subsequent case Itelcar. Following the CJEU case law, an anti-avoidance measure must target only wholly artificial arrangement conducted mainly for tax reasons.[127] In order for such a measure to not go beyond what is necessary, it must provide the relevant taxpayer the opportunity, without subjecting him to unreasonable administrative obligations, to provide evidence for valid commercial reasons of the targeted arrangements.[128] In doing so, the relevant measure must provide the taxpayer with the ability to understand the scope of the measure with sufficient precision.[129] In conclusion, even justified domestic anti-abuse measures may be considered as non-compatible with EU law if they do not meet the requirements of the principle of legal certainty.

2.5.1.2. The influence of the GAAR provided by the ATAD on legal certainty

GAARs, by their nature, are not providing a lot of legal certainty. They impose extra pressure on taxpayers that believe that their actions are completely legitimate since no SAAR applies in their

[123] Case C-318/10 Societe d'investissement pour l'agriculture tropicale SA (SIAT) v. Etat Belge, [2012] ECR-I 415, paragraph 58. (Hereinafter: **"SIAT"**).
[124] SIAT, paragraphs 3-6.
[125] SIAT, paragraphs 34-48.
[126] SIAT, paragraphs 56-57.
[127] Case C-282/12 Itelcar – Automoveis de Aluguer Lda v. Fazenda Publica, [2013] ECR – I 629, Paragraph 34. (Hereinafter: **"Itelcar"**).
[128] Itelcar, paragraph 37.
[129] Itelcar, paragraphs 43-44.

circumstances. Hence, there is a need to set a clear and precise definition of the terms included in the GAAR in order for it to be effective in terms of legal certainty. However, setting too strict terms in a GAAR might hinder its ability to confront new tax planning schemes that circumvent current SAARs. Countries usually use flexible terms in their domestic GAARs, while legal certainty is further provided by tax courts or tax authority practices and guidelines.[130] In the lack of such practices and due to the 'minimum standard' approach, there are several obstacles to legal certainty imposed by the GAAR provided by the ATAD.

The 'minimum standard' approach of the ATAD means that MSs are only obliged to the minimum standard provided by that directive. It means that theoretically MSs may adopt stricter anti avoidance rules than the ones provided by the ATAD. By doing so, MSs are committed to comply with EU law and to not create unjustified restrictions on EU fundamental freedoms. This approach makes it harder to ascertain the exact GAAR each MS will eventually adopt. Hence, the fact that the GAAR provided by the ATAD follows the 'minimum standard' approach inherently hurts legal certainty.[131] Moreover, the GAAR provided by the ATAD includes no definition to several meaningful terms, such as 'tax advantage' and 'defeats the object'. Each MS is competent to interpret these terms according to its domestic law, what increases the uncertainty regarding the practical application of GAARs based on the GAAR provided by the ATAD in MS's domestic tax legislation.[132] moreover, the most important feature of the CJEU case law on tax avoidance was the artificial requirement, which was not defined through the GAAR provided by the ATAD. This feature was implemented in the GAAR provided by the ATAD with the requirement for the targeted arrangements to be considered 'non-genuine'. The Commission merely guided MSs that 'non-genuine' arrangements are arrangements with no *"valid economic reasons which reflect economic reality"*. Also here, each MS is expected to adopt a slightly different concept of 'economic reality', which will cause further disparities.

Another feature of the GAAR provided by the ATAD that will probably cause disparities that will negatively effect on legal certainty is the sanction provided by it, the re-calculation of the tax liability in accordance to national law. The sanction by itself is not in much of clearance as compared to other GAARs. For example, the sanctions of the GAAR provided by the PSD and the PTT rule of Action 6 are coherent and precise – disallowing a certain tax benefit. If the sanction is re-calculation of the tax liability, it is not clear if it covers the application (or non-application) of certain taxes (e.g. withholding

[130] For examples: Daniel Gutman & Others, *The Impact of The ATAD on Domestic Systems: A Comparative Survey*, European Taxation IBFD, p. 9-12, January 2017.
[131] Ana Paula Dourado, *The EU Anti Tax Avoidance Package: Moving Ahead of BEPS?*, Intertax Vol. 44 440, p. 442-443, 2016. (Hereinafter: **"Dourado"**).
[132] Navarro, Parada and Schwartz, p. 12-13.

taxes) or applies only in circumstances of artificial erosion of tax liability.[133] That issue can be solved easily since it is clear that the legislator meant for the GAAR provided by the ATAD to have a very broad scope.[134] Even so, the reference to unitary calculation of the tax liability in accordance with the domestic law of the MSs will cause further disparities that may further hurt legal certainty.[135]

Conversely, the reliance on the CJEU case law provides taxpayers the ability to ascertain what would fall into the boundaries of the GAAR provided by the ATAD. The importance of the artificial requirement in the context of tax avoidance measures was clarified to MSs. The artificial requirement by itself was discussed in many CJEU cases, such as the concept of tax avoidance based thereon. Accordingly, even if each MS has different views regarding the concept of 'economic reality', the CJEU case law and different recommendations provided by the Commission do provide with a legal framework for MSs in that regard. The consequence is a mixed level of legal certainty derived by the GAAR provided by the ATAD. While the exact manner in which the tests of the provision are about to be used is quite vague, the main purpose and limitations of the provision are based on known precedents and provide for a sufficient degree of legal certainty as compared to other GAARs.

When evaluating the GAAR provided by the ATAD according to the requirements of the principle of legal certainty as provided by the CJEU in the SIAT and Itelcar cases, all of the requirements provided by these cases are accomplished. There is a direct connection to 'genuine arrangements' and the ability of the taxpayer to claim for a 'valid economic reason' is precisely stated in the provision. The taxpayer is not required to predict the scope of the GAAR, and no burdensome administrative obligations apply on him when trying to provide evidence to his valid economic activity.

2.5.2. The ability of the GAAR provided by the ATAD to confront abusive practices otherwise resulted in unjustified lower tax burden without hindering free trade

The most notable difference between the GAAR provided by the ATAD to the PPT rule is the artificial requirement (or the lack of artificial requirement in the PPT rule). The artificial requirement which evolved by the CJEU case law is directly reflected in the GAAR provided by the ATAD. Hence, the focus of the examination in this sub-part will be on cases in which allegedly abusive arrangements reflect a certain degree of 'economic reality' which raises questions regarding the accomplishment of the artificial requirement as found in the GAAR provided by the ATAD. The purpose of this sub-part is not to compare between the GAAR provided by the ATAD and the PPT rule. However, the inclusion of the

[133] Dourado, p. 442.
[134] Rigaut, p. 502.
[135] Navarro, Parada and Schwartz, p. 15.

artificial requirement in the GAAR provided by the ATAD is certainly the most important feature in determining if the provision should apply. The accumulative tests suggested by the EU Commission in its recommendation from 2012 will be used as guidelines for the functioning of the artificial requirement for the purposes of this sub-part. In addition, the following analysis disregards any SAAR that might apply in the cases under consideration.

Example 1: Company A which resides in country AC and provides international law services owns 100% of the equity in its subsidiary B which resides in country BC and provides accounting services. B accumulated profit after CIT of 100, while the withholding tax rate on dividend distributions to a foreign shareholder is 30%. Company C is an unrelated company which also resides in country BC and provides business management services. Company C has an accumulated loss of 10 which is carried over for few years and about to be diminished following the loss carry-over rules of country B. Company C and company B engaged in a contract by which B paid C an amount of 100 for management services. In parallel, company C and company A was engaged in a contract in which company A receives an amount of 90 from company C for law services, and a commitment by A for a discount of 10 on future law services. In consequence, the existence of these two arrangements caused country BC a revenue loss of 40 (30 from dividend withholding tax regarding the profits of company B, 10 on the recognition of profit against the loss carry over of company C). In case country BC is a MS which adopted a GAAR on the basis of the GAAR provided by the ATAD, could it re-characterize those arrangements?

In this case, the subjective test will probably be accomplished since there are several objective circumstances found in this example that when taken together points out on a main purpose of obtaining a tax advantage. Those circumstances are: The fact that A faced a 30% withholding tax, C faced with a loss which is about to expire, the amounts of the payments between B to C and between C to A are exactly correlate to the profit accumulated by B and the accumulated loss of C, and the amount of future discount on law services which promise that economically C would not lose its right to use the loss which is about to expire. The tax advantage was obtained due to the ability of B and C to deduct the relevant payments from the liable income. Such a circulation of the tax system of BC certainly undermines its purposes and fulfils the objective test too.

The main question regarding this example is about the fulfilment of the artificial requirement. When examining the circumstances of this case with the accumulative tests provided by the Commission recommendation from 2012 we get a mixed answer. The actions taken by the parties are regular business actions – rendering management and law services. If the amounts payed also correspond to market prices, it can be said that a reasonable entrepreneur would have engage in such arrangements. Those

characteristics may preclude the fulfilment of the artificial requirement since valid economic reasons which reflect economic reality are found. Against this conclusion, other functions of those arrangements point on their artificial nature. The payments are canceling each other and are taken in a circulative manner. Moreover, the expected profit of these arrangements for all parties involved is zero, while the tax advantage accumulated to 40. In my opinion, when considering all of those facts together, the circulative nature and the fact that the payments cancel each other should lead to the accomplishment of the artificial requirement of the GAAR provided by the ATAD.

Example 2: Company A is resident of state AC and owns shares of company B which is located in country BC. Company B imposes withholding tax of 30% on dividends paid to foreign shareholders. Company A enters to an arrangement with company C which located in country CC, by which company A assigns to company C the right to receive a dividend payment of 100 that have been declared but not yet paid by company B, in exchange of an asset with an evaluated worth of 90. Following a tax treaty between country BC and country CC, and the fact that C is considered as the beneficial owner of the dividend, no withholding tax imposed on the dividend distribution. The outcome of this arrangement is that country BC lost revenue of 30 due to the application of the arrangement between companies A and C. In case country BC is a MS which adopted the GAAR provided by the ATAD, can this arrangement be confronted?

Here, the application of a GAAR provided by the ATAD is questionable. Regarding the subjective element, the circumstances are clearly point on a main purpose of obtaining a tax advantage (no withholding tax). The amount of dividend, the value of the asset, the declaration of distribution before concluding the arrangements, and the fact that no shares were transferred reflect a strong tax motive. The fulfilment of the objective element is questionable. The purpose of double tax treaties is primary to eliminate double taxation, and eliminating the withholding tax in such a situation is not necessarily against that purpose of the treaty. The other purpose of tax treaties is to confront tax avoidance. Here, one might say that the arrangement is abusive and hence contradicts the purpose of the tax treaty. In such case, the fulfilment of the artificial requirement is crucial for the fulfilment of the objective element, since the question is the occurrence of abuse.

Apparently, the artificial requirement will not be fulfilled in this case. The legal substance of this arrangement is an exchange between an asset to the right to receive a declared dividend payment. Hence, the fact that a tax benefit was achieved is not against the legal substance of the arrangement. Such an exchange can be made by a reasonable entrepreneur who believes that he acquires an asset in low price. The arrangement is not of a circulative nature and its elements are not canceling each other. The only sub-

test that might be in favor of the fulfilment of the artificial requirement is the fact that the tax advantage is higher than the expected profit of the arrangement. In my opinion, such a case would not be confronted by the GAAR provided by the ATAD although in first sight it seems like a purely abusive arrangement.

In conclusion, although the GAAR provided by the ATAD has a concrete rational and is based on a coherent legal framework, it would not suffice to confront all of the possible tax avoidance schemes. The examples brought above demonstrate the obstacles for such GAAR to tackle certain schemes of tax avoidance because of the relatively strict artificial requirement. It is truth that MSs are free to conclude a stricter GAAR than the GAAR provided by the ATAD, though such legislation might be considered as not in line with EU law, so the ability to maneuver is pretty limited. It will be interesting to observe the CJEU approach towards interpretation of the artificial requirement of the GAAR provided by the ATAD especially due to the extremely broad scope of the provision which exceeds the boundaries of the internal market. Having said that, it has to bear in mind that the artificial requirement is mandatory in order for preventing tax authorities to hinder legitimate economic activities for the reason of raising revenues. The purpose of the GAAR provided by the ATAD is to tackle arrangements that do not fall inside the scope of any SAAR, and that fact should be taken into account when considering the GAAR's effectiveness. In my opinion, the GAAR provided by the ATAD fulfils the principle of legal certainty and has the ability to confront a broad range of abusive arrangements in a sufficient matter. Therefore, for the purpose of this thesis, the GAAR provided by the ATAD is considered as an effective provision.

2.6. Conclusion

This chapter contains a comprehensive analysis of the GAAR provided by the ATAD. The origin of the GAAR provided by the ATAD is the CJEU case law on the concept of tax avoidance. At first, the CJEU refused to accept the need of MSs to confront tax avoidance as a justification for a restriction on an EU fundamental freedom. In parallel, the CJEU developed a doctrine of abuse of laws in economic cases outside the field of direct taxation in which it set for the first time the objective and subjective elements required to justify a breach of a fundamental freedom on the basis of preventing abuse of laws. Those two elements combined with the artificial requirement was applied in the field of direct taxation in the Cadbury Schweppes and Thin Cap cases, and was given a recognition as EU law principles in several Commission communications and recommendations.

In 2016 the European Commission published its ATA Package which consists of several EU level legislative tools with the purpose of ensuring a level of minimum standard measures to be taken against tax avoidance. The ATA Package aims to be the response of the EU to the BEPS Project final reports which were published in October 2015. The ATAD is the most significant outcome of the ATA Package,

providing for six binding anti-avoidance measures including an EU GAAR which is directly influenced by the CJEU case law on tax avoidance. The GAAR provided by the ATAD is also combined with objective element, subjective element, and an artificial requirement. However, the Commission used slightly different terms than the ones used by some of the CJEU cases.

Some issues upheld regarding the legal certainty provided by the GAAR of the ATAD. The GAAR reflects the 'minimum standard' approach taken by the Commission in the formulation the ATAD. MSs has a limited degree of freedom to take into account their special circumstances when applying the GAAR provided by the ATAD in their domestic tax legislation. The most important notion of the GAAR, the artificial requirement, was left to be finalized by each MS through interpreting the term *"valid economic reasons which reflect economic reality"*. Eventually, considering the CJEU case law on the principle of legal certainty, it was concluded that the GAAR provided by the ATAD, combined with the CJEU case law and the EU Commission's communications accumulate to a sufficient degree of legal certainty.

The ability of the GAAR provided by the ATAD to confront abusive behavior otherwise was resulted in revenue loss is doubtful. The artificial requirement will prevent MSs of completely confront all the scenarios of tax avoidance and will provide taxpayers a possibility to circumvent the application of the provision. However, that requirement is a solid principle of EU law which ensures that restriction on EU fundamental freedoms will be justified on the basis of the need to confront tax avoidance only if the restrictive measure is proportionate and not beyond what is necessary. In this regard, the CJEU and the EU Commission consider the protection on principles that promote the internal market (e.g. the freedom of establishment) as more important than an absolute abolition of tax avoidance practices. However, the purpose of the GAAR provided by the ATAD is to cover situations that escaped from application of a relevant SAAR. When taking into account the existence of SAARs and the broad scope of the GAAR provided by the ATAD, it was mandatory to set a limit in the form of the artificial requirement in order to ensure that legitimate business operations are not hindered by aggressive tax authorities. Therefore, in my opinion, the GAAR provided by the ATAD is an effective anti-avoidance measure.

Chapter 3: The PPT rule provided by the BEPS Project's Action 6

3.1. Introduction

With the increasing volume of international trade in the years after the Second World War, the phenomenon of multiple countries claiming taxing rights on the same generated profits increased as well. It did not take much time before double taxation was recognized as a serious obstacle to international trade, making it less profitable. The OECD was formed in 1960[136] as the successor of the OEEC, an organization combined of representatives of western democratic countries with the purpose of developing cooperation between its members and advancing liberal principles, such as reducing obstacles for international trade. In 1963 the OECD published for the first time the MTC along with its Commentary, which is a recommended model of a bilateral tax convention which aims at eliminating double taxation in trade between the contracting countries. In present, the MTC is used as a starting point for negotiations over the vast majority of bilateral tax treaties. The MTC Commentary is used as an interpretation and guidance tool by contracting countries which followed the provisions provided by the MTC.[137] Unless specifically mentioned in the tax treaty, contracting states may only rely on the version of Commentary applied in the day of signature and not on later versions.

In our days, the issue of double taxation is settled in an effective manner through thousands of bilateral tax treaties. However, the growth of global trade combined with tax competition between countries enabled MNEs to lower the overall corporate tax burden imposed on them to almost zero. An important harmful tax planning scheme involving provisions concluded by tax treaties is generally named 'treaty shopping'.[138] Tax treaties aim at allocating the taxing rights between the contracting states in situations where both countries claim for a right to tax a certain profit. Moreover, tax treaties usually provide for tax benefits to residents of the contracting states. In general, Treaty shopping is a type of treaty abuse performed when a taxpayer is engaged in an economic activity with the only purpose of being eligible for tax benefits provided by a tax treaty. Several countries led by the US, began including in their tax treaties LOB provisions that preclude the right of a taxpayer to benefits provided by tax treaties in certain situations.[139] Those LOB provisions are formulated as domestic SAARs. Initially, The OECD choose to address this topic by providing guidance on the suitable way to confront treaty shopping through amendments of the MTC Commentary rather than adopting anti-avoidance measures in the MTC itself.

[136] Convention on the Organization for Economic Co-operation and Development, 14.12.1960.
[137] Lang, P. 33-34.
[138] Action 6, p. 17-18, paragraphs 17-18.
[139] For example: U.S. Department of the Treasury, *U.S. Model Income Tax Convention*, Article 22, February 17th 2016.

That reluctant approach taken by the OECD has changed considerably after the economic crisis of 2008 that imposed budgetary pressure on its members, which led to a cooperative action against international tax planning in the form of the BEPS Project.[140] One of the issues dealt by the BEPS Project is the issue of treaty shopping. Action 6 provides a recommendation to introduce new provisions to the MTC which prevent the granting of treaty benefits in inappropriate circumstances. Among six different LOB provisions, Action 6 also recommends on the inclusion of a GAAR in the form of a PPT rule.

This chapter contains an evaluation of the PPT rule provided by Action 6 in the same method used in Chapter 2 to evaluate the GAAR provided by the ATAD. The first part include an overview of the approach taken by the OECD regarding the fight against treaty shopping and other treaty abuse schemes before the introduction of Action 6. Further, I discuss the objectives and principles promoted by the BEPS Project in general and by Action 6 in specific. Finally, I conduct an examination of the effectiveness of the PPT rule through an overview of its features, its compatibility with legal certainty requirements, and its ability to deny tax benefits in cases of treaty abuse without hindering free trade. For the purpose of this chapter, the term 'tax treaties' refers to tax treaties which are based on the MTC and its Commentary unless another meaning mentioned.

3.2. The concept of treaty abuse in the MTC

As mentioned in sub-par 3.1, bilateral tax treaties are the dominating source of law in the field of international taxation. As a consequence, much of the efforts of MNEs to circumvent tax rules in order to reduce their overall tax burden are focused in tax treaties. An exact definition for situations which are considered as treaty abuse, as always, depends on the concept of abuse applied on the situation. The reason for that conclusion is the absent of a definition to the term 'treaty abuse' through the MTC Articles. According to Article 3(2) of the MTC, if a term is not defined through the treaty itself and the context does not require otherwise, this term shall *"have the meaning that it has at that time under the law of that state"*. It is true that the 'context' might be the guidance provided by the MTC Commentary on the interpretation of the term. However, countries deviate regarding the importance they refer to the MTC Commentary, so its influence is questionable. A broad definition for the term 'treaty abuse' is provided by Action 6: *"Taxpayers engaged in treaty shopping and other treaty abuse strategies undermine tax sovereignty by claiming treaty benefits in situations where these benefits were not intended to be granted"*.[141]

[140] Brauner, p. 63-64.
[141] Action 6, p. 9.

The intensive work of the BEPS Project on the issue of treaty abuse proves that countries usually make a distinction between treaty abuse and a regular abuse of their domestic law. If treaty abuse is not different than abuse of domestic tax law, than both situations should be confronted by domestic anti-abuse measures. In that case, there is no need for the MTC to deal with treaty abuse. Some countries do apply their anti-avoidance measures to confront treaty abuse. However, the predominant opinion in that regard says that domestic anti-abuse legislation does not apply on benefits provided by tax treaties. The reason is that if each contracting state will interpret the tax treaties with reference to its own domestic tax law, the application of the treaty would be asymmetrical. Tax treaties are caught as a separate legal system ruled by international law, hence countries hold different approaches towards tackling treaty abuse through domestic anti-abuse measures[142]. The approach of the MTC regarding treaty abuse had changed considerably through the years. Initially, no reference to the issue of abuse was found in the MTC and its Commentary. If the suggestions of Action 6 will be adopted, the MTC will contain several LOB provisions and a PPT rule, both with the sole purpose of confronting treaty abuse. The next sub-parts designated for an overview of the evolution of the concept of treaty abuse as reflected by the amendments made to the MTC Commentary in the last decades.

3.2.1. From initial publication in 1963 through the 1977 and 1992 updates

In the absent of anti-avoidance measures in the MTC itself, the legal basis for the denial of treaty benefits found in the statements of the OECD Committee on Fiscal Affairs provided by the MTC Commentary. Bilateral tax treaties which generally based on the MTC usually include a reference for the version of the Commentary applied in the time of the conclusion of the treaty, and use it as interpretive tool of the treaty provisions. The MTC Commentary did not deal with any matters of treaty abuse until its 1977 update. Hence, contracting countries could not deny treaty benefits provided by treaties which were designed on the basis of the MTC and concluded before the 1977 update.[143]

The importance of the MTC increased while no instructions regarding treaty abuse was provided. This situation enabled taxpayers to enjoy multiple benefits through the creation of artificial establishments for residence purposes. The OECD Committee on Fiscal Affairs acknowledged that along the purpose of fostering international trade by eliminating double taxation, tax treaties should not be used as a tool which promotes abusive behavior.[144] Hence, in the 1977 update of the MTC Commentary on Article 1 regarding the persons covered by the treaty concluded that: *"It may be appropriate for contracting states to agree in*

[142] Lang, p. 64-66.
[143] Lang. p. 66.
[144] Luc De Broe & Joris Luts, *BEPS Action 6: Tax Treaty Abuse*, Intertax Vol. 43 Issue 2 122, p. 122, 2015. (Hereinafter: **"De Broe & Luts"**).

bilateral negotiations that any relief from tax should not apply in certain cases, or to agree that the application of the provisions of domestic laws against tax avoidance should not be affected by the Convention".[145] In practice, the 1977 update did not provide any effective tool for contracting states to confront treaty abuse. Moreover, it even clarified that domestic anti-avoidance legislation does not apply on benefits provided by a tax treaty. In order to deny a treaty benefit of an eligible taxpayer on the basis of treaty abuse, the contracting countries should agree on specific anti-avoidance measures. In the absent of anti-avoidance provisions in the MTC there was no practical meaning to that statement since countries could decide on treaty anti-avoidance measures without it.[146]

The same statement retained in the 1992 update of the MTC,[147] though considerations regarding the application of domestic anti-avoidance measures on tax treaty provisions were added. The Commentary on Article 1 provided the confronting opinions demonstrated by the members of the OECD Committee on Fiscal Affairs. The majority of the OECD member countries were of the opinion that since domestic anti-avoidance rules are not specifically addressed in tax treaties there is no affection on their application. Since those rules determine the overall tax liability of the taxpayer there is no reason for not applying them on tax treaties. The minority opinion stated that the purpose of tax treaties is first and all to eliminate double taxation and a general legal doctrine which enables the denial of treaty benefits in situations of abuse should not apply (e.g. substance over form). Hence, without including anti-avoidance provisions in the treaty itself, contracting states are lacking of legal basis to deny treaty benefits. The existence of different opinions combined with the statement of the 1977 update resulted in practical continuation of the same legal situation in which contracting states are able to deny treaty benefits only upon a special agreement between them.[148]

3.2.2. The 2003 update

The inconsistency in the approach taken by the OECD through the MTC regarding treaty abuse was eliminated completely by the 2003 update.[149] The OECD Committee on Fiscal Affairs had fundamentally changed its position regarding treaty abuse and the relations between domestic anti-avoidance measures and tax treaties. Essentially, the 2003 update provided a legal framework for contracting countries to

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145 OECD (1977), *Model Tax Convention on Income and on Capital 1977*, OECD Publishing. (Hereinafter: **"1977 Update"**).
146 Lang, p. 67.
147 OECD (1992), *Model Tax Convention on Income and on Capital 1992*, OECD Publishing.
148 Lang, p. 67.
149 OECD (2003), *Model Tax Convention on Income and on Capital 2003*, OECD Publishing. (Hereinafter: **"2003 Update"**).

confront treaty abuse. The MTC Commentary on Article 1 was reformed with the replacement of the statements provided by the 1977 and 1992 updates with a new comprehensive concept of treaty abuse.

The purpose of preventing tax avoidance and evasion was recognized for the first time as a general principle of tax treaties. However, following the wording of the relevant provision it seems that the prevention of tax avoidance is only ancillary purpose to the main purpose of eliminating double taxation.[150] Even so, the ratification of the need to prevent tax abuse as a purpose of tax treaties has a great influence on tax treaty interpretations. The Commentary make a distinction between two types of countries: those who consider treaty abuse as an abuse of the treaty itself, and those regard treaty abuse as abuse of their domestic law. If the contracting country consider treaty abuse as abuse of the treaty itself, the inclusion of the need to prevent tax avoidance as a general purpose of tax treaties provide the relevant country for a legal framework to deny treaty benefits.[151]

If a contracting country sees treaty abuse as abuse of its domestic tax law, it can use its domestic anti-abuse rules to confront treaty abuse, as long as those rules are not directly addressed or affected by treaty provisions.[152] Moreover, the Commentary concludes that as a general rule domestic GAARs, judicial doctrines[153] (e.g. substance over form) and CFC rules[154] does not conflict with tax treaties, unless otherwise expressly provided by the treaty. The Commentary does not deny the application of domestic SAARs on the treaty itself and even warns contracting countries that the fact that their domestic GAAR might apply does not provide for the suffice protection against treaty abuse.[155]

The OECD Committee on Fiscal Affairs was aware of the differences among tax systems regarding the definition of the term ‘treaty abuse’. In order to reduce those differences as much as possible, and considering countries’ tax sovereignty, it provided for a flexible principle to follow regarding situations in which treaty benefits should be precluded:

“Where a main purpose for entering into certain transactions or arrangements was to secure a more favorable tax position and obtaining that more favorable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions. It should not be lightly assumed that a taxpayer is entering into this type of abusive transactions”.[156]

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[150] MTC, Commentary on Article 2, paragraph 7.
[151] MTC, Commentary on Article 1, paragraph 9.3.
[152] MTC, Commentary on Article 1, paragraph 9.2.
[153] MTC, Commentary on Article 1, paragraph 22.1.
[154] MTC, Commentary on Article 1, paragraph 23.
[155] MTC, Commentary on Article 1, paragraph 9.6.
[156] MTC, Commentary on Article 1, paragraph 9.5.

It is not surprising that this principle is the basis for the PPT rule provided by Action 6. This principle is formulated as a GAAR which contains a subjective element *("main purpose.. to secure a more favorable tax position")*, and an objective element (*"contrary to the object and purpose of the relevant provisions"*). However, the Commentary does not provide for any further information regarding the meaning of different terms of that principle. The principle was deliberately formulized in a flexible fashion in order for countries will be able to use it in accordance with their tax systems. The fact that the BEPS Project choose to devote a separate part for the issue of treaty abuse suggest that the revision conducted in the 2003 update was not satisfying. It has to bear in mind that the 2003 update has no impact on tax treaties concluded before its application. The critics of that principle claimed that it was phrased in a too broad and vague fashion, with the outcome of inappropriate legal certainty and erosion of the original purpose of tax treaties. Moreover, some countries publicly criticized the OECD position regarding the relationship between tax treaties and domestic anti abuse in general and domestic CFC rules in specific.[157] Eventually, the 2003 update did not provide sufficient tools to effectively confront treaty abuse.[158] However, it was the first try taken by the OECD to set a generally accepted principle regarding treaty abuse. The principles provided by the 2003 update led the way to the aggressive approach of confronting treaty abuse provided by Action 6.

3.3. The approach taken by the OECD through its BEPS Project

The BEPS Project, albeit providing recommendations which are not practically binding, is in assent a revision of the generally accepted international tax rules. The respectable amount of countries involved in the project,[159] and the success of the other project taken by the OECD in the field of international taxation (the MTC) remarks the good potential the BEPS Project has to be adopted by the vast majority of countries. Moreover, the immediate reaction of the European Commission to the BEPS Project final reports through the ATA Package is another sign to that direction.

In order to evaluate correctly the effectiveness of the PPT rule provided by Action 6 it is first important to acknowledge the aims and principles promoted by the BEPS Project as a whole. This part begins with an overview of the pre-BEPS Project atmosphere in the field of international taxation and the reasons that urged the OECD, supported by the G20, to conduct the enormous BEPS Project. Afterward I discuss the aims and principles governing the BEPS Project. Finally, the role and purposes of Action 6 are presented and evaluated considering the extent in which Action 6 is compatible with the BEPS Project principles.

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[157] MTC, Commentary on Article 1, paragraphs 27.4-27.9.
[158] De Broe & Luts, p. 124.
[159] BEPS Project's Explanatory Statement, p. 4-5.

3.3.1. The pre-BEPS Project environment of international taxation

Although each sovereign country is basically free to design its tax system according to its own needs and circumstances, the vast majority of international tax issues are governed by the law of thousands of bilateral tax treaties. In that respect, taking into account the dominance of the MTC as the basis of tax treaties, one would say that the OECD is already functions as an international organization which facilitates the principles and guidelines in the field of international taxation, or at least provides customary international law.[160] However, the OECD approach in that regard was quite ambivalent. Albeit the OECD did try to standardize and provide general guidance on international tax issues that can be used worldwide, it was always caught as a representative of the interest of the rich countries that has no authorization to intervene in considerations taken by non-member countries. Practically, before the BEPS Project the OECD did not function as the provider of worldwide generally accepted principles in the field of international taxation but merely promoted the interest of its member countries (e.g. the movement towards more residence taxation on the expense of source taxation).[161]

Competition on investments and revenues was always a main feature of the international tax regime. Cooperation between countries as promoted by the OECD was focused on the removal of obstacles for free trade with the elimination of double taxation. Therefore, cross-border aggressive tax planning was not confronted in a comprehensive cooperative manner. The paradigm of residence and source taxation was suitable for an economy that is based on physical presence. The globalization brought for increasing mobility of labor and capital that raised problems for a paradigm which is dominated by unilateral decisions of countries. That movement towards mobile economy and the tax benefits suggested by countries due to the worldwide tax competition reduced the dependence of MNEs on their residence countries.[162] MNEs started to organize in legal formations that provided them with the lowest overall tax burden. The inability of countries, which are regular to compete with each other on taxes, to cooperate in order to confront that abusive behavior, enabled MNEs to enjoy both worlds – tax benefits deliberately provided to attract them to jurisdictions and further shifting of their profits to the lowest tax burdensome jurisdiction.[163]

These developments in modern economy resulted in a swift of economic power from the member countries of the OECD to their own MNEs. The massive tax competition taken by countries gave MNEs

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[160] Reuven Avi-Yonah, *International Tax as International Law*, University of Michigan Law School, Law & Economics Working Papers Archive: 2003-2009, Paper 007-04, p. 20-26, 2004.
[161] Brauner, p. 62-63.
[162] Brauner, p. 63-64.
[163] BEPS Project's Explanatory Statement, p. 4.

a lot of bargaining power towards tax conditions regarding certain economic activities. In nowadays, some MNEs accumulated higher economic power even then medium-sized countries.[164] The dominance of residence taxation promoted by the OECD was also reversed towards more source taxation due to the influence of emerging economies such as China, India and Brazil (e.g. the "service PE" which enables source countries to tax services conducted by non-PE in their territory).[165] Those heavily populated countries realized that their actual economic power enables them to promote source taxation which is more beneficial to them as producing countries. Those reasons and especially the consequences of the 2008 economic crisis urged the OECD member countries to look for more revenues from taxes.[166]

Logically, most of the political pressure to change the paradigm of international tax regime came from the direction of the developed countries. These countries suffered the hardest hit from the economic crisis and were expected by their civilians to finance programs to recover the financial markets. Moreover, most of the economic power accumulated by MNEs was gained on the expense of the developed countries which provided the economic atmosphere for the MNEs profitability, but could not put their hands on a fair share of taxes. The developing countries also lost some economic power to MNEs, but they did not need to deal with the same political pressure such as developed countries regarding expanses for the benefit of the society. Even so, the developing countries did not want to stand aside once again when a new legal framework of international taxation was developed, and decided to fully participate in the BEPS Project.[167] The cooperation between developed and developing countries in a try to design a new international tax regime created a real opportunity to change the competition oriented approach of international taxation to an approach that based on cooperation and transparency which might confront international tax planning effectively.[168]

3.3.2. The principles and guidelines governing the BEPS Project

Unlike the EU concept of tax avoidance that was developed under the CJEU case law following established EU law doctrines (e.g. the prohibition of abuse of law and the rule of reason) the concept of tax avoidance provided by the BEPS Project is not based on a coherent legal framework. Albeit the 2003 update of the MTC Commentary do recognize the need to confront tax avoidance as a purpose of tax treaties, its scope is limited to interpretation of some tax treaties, while direct anti-avoidance Articles was

[164] For example see: Vincent Trivett *25 US Mega Corporations: Where They Rank If They Were Countries*, Business Insider, 27.6.2011. Can be found at: www.businessinsider.com/25-corporations-bigger-tan-countries-2011-6?international=true&r=US&IR=T.
[165] MTC, Commentary on Article 5, paragraph 42.23.
[166] Brauner, p. 57-58.
[167] BEPS Project's Explanatory Statement, p. 4-5.
[168] Fichtner & Michel, p. 23-24.

never included in the MTC. In the lack of a legal process in which a coherent concept of tax avoidance is developed, and taking into account the large number of issues dealt by the BEPS Project, it is hard to detect the exact principles promoted by the BEPS Project in each and any recommendation. However, an overall examination of the different Actions provided by the BEPS Project does provide for general principles that were followed, even if not in each and every recommendation.[169]

The general aim of the BEPS Project, as repeated in all of the explanations to the initial and final reports, is to align taxation with economic activities and value creation.[170] This notion is better understood when viewing some of the innovative solutions provided by the BEPS Project. For example, the recommendation on the 'nexus approach' regarding IP Box regimes.[171] In general, IP Box regimes provides for low tax rates on profits generated from qualified IP assets. Countries apply IP Box regimes in order to attract R&D investments to their country. However, MNEs sometimes locating yielding IP assets in certain jurisdiction only to enjoy the IP Box regime benefits, without actually investing at R&D in the relevant country. Following the 'nexus approach', countries will grant the benefits of their domestic IP Box regimes only to extent that the R&D expenses which connected to the revenues from the IP were expensed in their territory.

The example of the 'nexus approach' reflects the adherence of the BEPS Project to formulary apportionment methods for splitting income between countries rather than residence and source taxation based on the arm's length principle. However, this kind of conclusion would be incorrect. It is true that there is some movement to that direction, reflected also by the allegedly acceptance of formulary apportionment methods regarding the transfer of hard-to-value intangibles between connected parties.[172] Nevertheless, the arm's length principle is still the absolute principle regarding transfer pricing methods for evaluating the vast majority of assets. The adherence to a kind of formulary apportionment method is limited to unique intangibles, without even using the term 'formulary apportionment'. A principle that can be reflected by the notion of aligning taxation with value creation is the willingness of accepting

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[169] Brauner, p. 112-113.

[170] See: OECD (2014), *Explanatory Statement*, OECD/G20 Base Erosion and Profit Shifting Project, p. 3, OECD. (Hereinafter: **"Explanatory Statement 2014"**). BEPS Project's Explanatory Statement, p. 4.

[171] OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*, Action 5 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, p. 24-25, Paris.

[172] OECD (2015), *Aligning Transfer Pricing Outcomes with Value Creation*, Actions 8-10 – 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, p. 109-112, Paris.

innovative solutions of profit split-off between countries that contradicts the traditional solutions of residence and source taxation.[173]

The second principle promoted by the BEPS Project is the need to move from international tax regime which is based on competition to an international tax regime based on cooperation. In that regard, the BEPS Project recognizes and respects the differentiations between countries' tax systems. The principle of cooperation means that countries should at least put an effort to conclude rules that enables coordination with other countries' legislation.[174] The BEPS Project promotes coordination between countries' domestic tax laws in three ways: (1). recommending on unified rules that can be implemented directly in countries' domestic tax legislation and tax treaties. (2). Recommendations on the best practices dealing with administrative and compliance issues and disputes between countries. (3). Promoting transparency through collaboration in the field of information exchange, and the foundation of a multilateral instrument for that purpose.[175]

The third principle promoted by the BEPS Project is directly connected to the second principle. In order to swift from an international tax regime that is based on competition to an international tax regime based on cooperation, there is a need for a guiding principle regarding the interaction between countries. Hence, countries are expected to see international taxation issues in a substantive manner and always look on the other side of the border. Domestic international tax rules should take a holistic approach rather than ad-hoc solutions.[176] An example to this principle is the requirement to not create double-taxation as a consequence of applying anti-avoidance measures.[177]

3.3.3. The formation of the BEPS Project and the role of Action 6

The BEPS Project is combined with 15 Action plans, each deal with a different issue of international taxation. In general, it is possible to divide the 15 Actions to three categories: (1). The application of broad international standards that supposed to revise the current international tax regime regarding the digital economy. This group includes Actions 1 (addressing the tax challenges of the digital economy), 5 (countering harmful tax practices more effectively) and 15 (developing a multilateral instrument to modify bilateral tax treaties). (2). the 'main body' of the BEPS Project, Actions that provide substantive norms and measures ready to implementation in domestic tax legislation or bilateral tax treaties. This group includes Actions 3 (CFC rules), 4 (Interest deduction limitation rules), 6 (treaty abuse), 7 (PE

[173] Brauner, p. 58.
[174] Brauner, p. 67-68.
[175] Fichtner & Michel, p. 25-26.
[176] Brauner, p. 58.
[177] Explanatory Statement 2014, p.3.

status) and 8-10 (aligning transfer pricing with value creation). (3). Actions that provide rules that promote transparency and information exchange between tax authorities. This group includes Actions 11 (measuring and monitoring BEPS), 12 (mandatory disclosure rules of aggressive tax planning) 13 (transfer pricing documentation) and 14 (dispute resolution mechanism).[178] Some authors consider Action 15 as being in a separate group since the develop of multilateral body which deals with international tax issues is a key aim of the BEPS Project as a whole and not only an 'international standard'.[179]

The issue of treaty abuse was recognized as one of the most harmful practices in the area of BEPS. In the initial BEPS Project report provided in 2013, the issue of current anti-avoidance measures and its effectiveness in treaty abuse situations was detected as a key issue.[180] Action 6 contains three areas in which it was recommended to take action in order to confront effectively treaty abuse.[181] First and most important is the introduction of new anti-abuse measures that supposed to be included in the MTC Articles. It includes six LOB provisions (SAARs) and the PPT rule (GAAR). This package of anti-avoidance measures applies simultaneously with the aim to catch treaty abuse through provisions found in the tax treaty itself. Second, an inclusion of a general declaration in the MTC clarifying that tax treaties are not intended to be used to generate double non-taxation. Third, it provides guidance to countries regarding considerations that should be taken before entering to a bilateral tax treaty.

The rules provided by Action 6 do not derogate the application of any other rules or principles provided by the BEPS Project. In fact, the recommendations provided by Action 6 are directed to a revision of the MTC itself rather than implementation in domestic laws. However, it means that the OECD is aware of the conflict that may arise between a domestic GAAR to the PPT rule found in a country tax treaty. Hence, it would be incorrect to say that Action 6 provide rules which scope is limited to tax treaties, while in practice the recommendations of Action 6 might influence domestic legislation too. Accordingly, and in order to evaluate the effectiveness of the PPT rule correctly, it will be examined considering the potentially broad scope it might have and not as a rule which is limited to certain tax treaties.

3.4. Overview of the PPT rule

3.4.1. The role of the PPT rule in Action 6

[178] Fichtner & Michel, p. 25.
[179] Brauner, p. 69.
[180] OECD (2013), *Addressing Base Erosion and Profit Shifting*, p. 37-38, OECD Publishing.
[181] Eric Pinetz, *Final Report on Action 6 of the OECD/G20 Base Erosion and Profit Shifting Initiative: Prevention of Treaty Abuse*, IBFD bulletin for international taxation 113, p. 113, January/February 2016. (Hereinafter: **"Pinetz"**).

Following the dominance of the MTC, the modification of its articles and Commentary is used as a proxy to a reform aimed at strengthen the internationally accepted rules regarding treaty abuse in general, and treaty shopping in specific. Action 6 is divided into three parts. Part A provides the main rules and principles that govern the new policy of the OECD regarding treaty abuse, including LOB rules, the PPT rule, and explanations on the best manner to implement and use the new measures. Part B includes a recommendation to add the preamble of the MTC a clarification that tax treaties are not intended to be used to generate double non-taxation. Part C provides for general instructions and guidance regarding the considerations states should take into account when entering into a tax treaty with another country. In assent, this recommendation detects 'suspect' jurisdictions which deliberately enable different kinds of tax planning.

A general distinction is made between states which consider treaty abuse as abuse of their domestic law (since taxes are ultimately imposed by domestic law while tax treaties only allocate taxing rights between jurisdictions) to states which consider treaty abuse as an abuse of the treaty itself.[182] It is clear that under both approaches states should prevent the granting of treaty benefits in situations of treaty abuse.[183] However, while the states in the second category can prevent the granting of treaty benefits through a proper construction of anti-abuse measures in the treaty itself (particularly the LOB and PPT rules), the first category of states might think that abuse of tax conventions can be only considered as abuse in case a relevant domestic provision considers it as abuse. Regarding the first category of states, changes to domestic legislation is recommended alongside the adoption of the LOB and PPT rules in their tax conventions itself. In fact, the LOB and PPT rules are mainly relevant to those states that considers treaty abuse as an abuse of the treaty itself, hence their domestic anti-abuse measures are not sufficient to confront treaty abuse.[184]

The LOB rule sets further conditions for taxpayers which claim for treaty benefits. It has to bear in mind that according to Articles 1 and 2 of the MTC, the conditions for application of the treaty is that the taxpayer is a resident of one of the contracting states, and that the taxes under consideration are taxes on income or capital. Albeit the LOB provision does not precludes the application of the treaty itself, denial of treaty benefits has the same outcome. The aim of the LOB provision is to preclude certain taxpayers from treaty benefits if the structure of their business is suspect as treaty abuse. It includes safe harbors and exemptions for its application, targeting at diminishing the creation of such abusive structures at the first place.

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[182] Action 6, p. 80-81, paragraphs 10-12.
[183] Action 6, p. 81, paragraph 13.
[184] Action 6, p. 55, paragraph 1.

It is evident that with the application of a SAAR such as the LOB rule, the exact targeted behavior will probably vanish quite quickly. However, it is also evident that taxpayers will try to find new structures that the relevant SAAR would not apply on, but would obtain the same outcome of tax avoidance. The PPT rule is aimed at targeting arrangements which the LOB rule does not apply on but still constitutes treaty abuse. The LOB and PPT rules are simultaneously applied, so for a taxpayer to achieve the treaty benefit which he assume that he deserves, he has to escape the application of both provisions.[185]

3.4.2 The scope of the PPT rule

As mentioned in sub-par 3.4.1, the PPT rule (and also the LOB rule) is designated for those states which see treaty abuse as abuse of the treaty itself, and hence their domestic anti-abuse rules do not apply on treaty abuse situations.[186] It means that the PPT rule is supposed to function as a completing tool for domestic anti-avoidance measures or juridical doctrines as 'substance-over-form' if these measures do not apply on treaty abuse situations. Considering the non-retroactive nature of the MTC, countries that would like to include the PPT rule in their tax treaties will have to amend their bilateral tax treaties, a process that takes time and not always desired by all the parties (e.g. one contracting state confronts treaty abuse using a domestic GAAR and hence does not need to amend the treaty, while the other contracting state will desire the amendment).

Furthermore, the PPT rule suggested as a new Article in the MTC itself. Although many tax treaties are based on the MTC, it does not have a worldwide application. A lot of developing countries prefer to follow the UN Model Tax Convention which is promoting more source taxation over residence taxation in comparison to the MTC.[187] Another important group of countries that does not follow the MTC is the BRIC countries which consider the MTC as non-suitable for their large economies which are based on relatively low labor costs and specialized in production. All of the above reflects the potentially limited number of countries that will actually need a provision such as the PPT rule.

The application of the PPT rule is limited to the respective tax treaty, and merely aims at denying treaty benefits in case a treaty abuse is found. Hence, tax benefits granted by other means than the relevant tax treaty are not covered by the PPT rule. [188] In fact, it is possible that the PPT rule does not even cover the entire treaty. Its application is restricted to deny a "*treaty benefit in respect of an item of income or*

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[185] Carlos Palao Taboada, *OECD Base Erosion and Profit Shifting Action 6: The General Anti-Abuse Rule*, IBFD bulletin for international taxation 602, p. 605, October 2015. (Hereinafter: **"Taboada"**).
[186] For example: Lang, p. 64-65.
[187] Lang, p. 32-33.
[188] Michael Lang, *BEPS Action 6: Introducing an Anti-abuse Rule in Tax Treaties,* WU International Taxation Research Paper Series 2014-09 655, p. 656, 19th of May 2014. (Hereinafter: **"Lang 2014"**).

capital", which has several implications. Articles 1-4 of the MTC provide rules on the application and definitions of the treaty, but no benefits. Third, it is not clear if some of the provisions of the MTC, such as the non-discrimination provision (Article 24), the mutual agreement provision (Article 25) or the exchange of information provision (Article 26) provides for benefits as meant by the PPT rule.[189] Such a conclusion would mean that the application of the PPT rule is limited to the denial of benefits in the form of no (or limited) taxation in the source state, and the prevention of double taxation by the residence state (the method Article).

3.4.3. The formation of the PPT rule

According to Action 6, a new Article under the name 'entitlement of benefits' shall be added to the MTC. Paragraphs 1-6 of this new Article are devoted to the LOB rule, its definitions, scope of application and exemptions. Paragraph 7 of the new Article provides with the PPT rule and written as follows:

"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 the 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".

Although the main core of GAARs such as the GAAR provided by the ATAD and other domestic GAARs is also found at the PPT rule in the form of subjective and objective tests, the PPT rule includes several unique features regarding these tests. The most obvious notion in the PPT rule is the absence of an artificial requirement of any kind. It means that following the PPT rule there is no formal connection between the occurrence of treaty abuse and economic substance. The suggested Commentary on the PPT rule provides for a 'soft' connection between treaty abuse and economic substance, concluding that when the competent tax authority considers the application of the provision it needs to *"regard all the relevant facts"*. Economic substance is one of the relevant facts that should be considered when applying the PPT rule. Some of the examples to the application of the provision follow an artificial business structure that highlights the affection of artificiality on the functioning of the PPT rule.[190] However, considering the role of the Commentary as a tool of interpretation, the absence of the artificial requirement in the provision itself certainly enlarges the power given to tax authorities regarding their decision to apply the PPT rule.

[189] Lang 2014, p. 657-658.
[190] Action 6, p. 58, 68-69, paragraphs 13 and example F.

In order for the subjective element to be fulfilled, it requires that *"it is reasonable to conclude, having regard all the relevant facts and circumstances, that obtaining that benefit was one of the principal purposes on any arrangement that resulted in that benefit"*. This element has few notions that raise some questions. First, the standard of proof provided by the PPT rule is 'reasonable', which is a light standard of proof compared to other anti-avoidance measures. Second, the subjective element of the PPT rule refers to 'principal or one of the principal purposes', meaning that the purpose of obtaining the treaty benefit should not be the 'sole' or 'most important' purpose of the arrangement in order for the provision to apply. The outcome of these features of the subjective element combined with the lack of artificial requirement provides a GAAR which is extremely biased in favor of tax authorities.

At first sight, the objective element does not differ materially from other objective element usually provided by GAARS. However, in the PPT rule the objective element functions as an exception to the application of the provision, and not as an element that should be fulfilled in order for the provision to apply. In fact, this formation of the objective element materially shifts the burden of proof of this element from tax authorities to taxpayers.[191] In the next sub-part each of the elements presented her will be analyzed in order to understand the practical function of the PPT rule.

3.4.4. The terms and elements of the PPT rule

In the lack of any artificial requirement, and since the objective element functions as an exception, the subjective element is the main requirement for the application of the PPT rule. It requires that the 'principal purpose or one of the principal purposes' of the targeted arrangement or transaction was to obtain a treaty benefit. There is a need to prove 'intention' of the relevant taxpayer to engage in an activity for the purpose of gaining a tax benefit. However, this proof of 'intention' has several characteristics which are certainly in favor of tax authorities and contradicts generally accepted taxpayer's rights.

First is the standard of proof. The competent tax authority shall apply the PPT rule in case it finds it 'reasonable' that an arrangement or transaction was taken with the principal purpose or one of the principal purposes of obtaining a tax benefit. It has to bear in mind that a conclusion by which a taxpayer was engaged in abusive practices has a dramatic effect on the taxpayer's economic outcome and his reputation. His economic expectations will not be fulfilled, he might be exposed to double taxation, and will be condemned by the public. Hence. Anti-avoidance measures usually applies stricter standard of proof than 'reasonless' which can be easily concluded by tax authorities. Such a light standard of proof is

[191] Pinetz, p. 116-117.

in substance a shift of the burden of proof to the taxpayer.[192] If the burden of proof is on the taxpayer shoulders, it would be almost impossible for the taxpayer to show that although his action secured him a treaty benefit, it was not one of the main purposes of its action.[193] It is interesting to see the difference between the relatively strict standard of proof found in the GAAR provided by the 2003 update of the MTC Commentary *("it will not lightly be assumed")*[194] to the lightened standard of proof found in the PPT rule, which reflects the failure of the 2003 update to effectively confront treaty abuse.

The notion of 'principal or one of the principal purposes' was also used by the GAAR provided by the amended Mergers Directive,[195] and deviates from the notion used in the GAAR provided by the 2003 update of the MTC Commentary ('main purpose'). However, apparently this is not a substantial difference, while both methods do not require the purpose of obtaining the tax benefit to be the 'sole' purpose of the arrangement. The PPT rule does not restrict the tax authority substantially when she believes that a certain arrangement is abusive. There is no requirement for the tax authority to provide a clear evidence of abusive intentions, but merely show that objectively it is reasonable to conclude that the obtaining of the tax benefit was one of the principal purposes.[196]

When adding the bias in favor of tax authorities to the requirement for the purpose of gaining a treaty benefit to only be one of the principal purposes and to the lack of artificial requirement, it seems like the subjective element is too harsh with taxpayers. Nevertheless, the PPT rule does not even require the benefit to be given directly to the targeted taxpayer, while indirect benefits (e.g. given to another member of a group of companies) will not preclude the application of the provision. The conclusion regarding the subjective element is that although it seems like it is of a neutral nature (since the burden of proof is allegedly on tax authorities) the overall implication of it is certainly biased in favor of tax authorities.[197]

This bias only expands when considering the objective element. First, the objective element provided by the PPT rule is in the form of an exception. Some will consider exceptions to be interpreted in a narrow fashion, although it seems like this rule of interpretation does not apply when interpreting treaties. Nevertheless, the objective element is an exception to an exception – the normal situation is granting the benefit, the subjective element might preclude it (first exception), and the objective element is an

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[192] De broe & Luts, p. 132.
[193] Taboada, p. 604-605.
[194] MTC, Commentary on Article 1, paragraph 9.5.
[195] Directive 2009/133/EC of the Council on the Common System of Taxation Applicable to Mergers, Divisions, Partial Divisions, Transfers of Assets and Exchanges of Shares Concerning Companies of Different Member States and to the Transfer of the Registered Office of an SE or SCE Between Member States, O.J. L 310/34, Article 15(1)(a), 25.11.2009.
[196] Lang 2014, p. 658-659.
[197] Lang 2014, p. 659.

exception to that.[198] However, it will be legally correct to set the objective and subjective elements on the same level. While for proving intention the tax authority should show that it is 'reasonable' to conclude that the intention existed, for the taxpayer to apply the exception provided by the objective element, he needs to 'establish' that the granting of the benefit was in line with the purpose of the relevant provision of the treaty.[199] It is not clear why the standard for tax authorities is easier to achieve than the standard devoted for taxpayers.

If the objective element is merely functions as an exception, it does not function as a defensive claim of the taxpayer and should be proven by the tax authority. If such interpretation is the correct one, the bias in favor of tax authorities is considerably reduced.[200] However, in my opinion, the use of the notion 'unless' before the objective element points out that it is on the taxpayer's shoulders to 'establish' that the granting of the treaty benefit was in line with the purpose of the treaty, meaning that the objective element functions as an exception which is a defensive claim of the taxpayer. The fact that the burden of proof regarding the objective element relies on the taxpayer's shoulders imposes further administrative burden on him which is considered as a sanction by itself.

Against that conclusion of a bias in favor of the tax authority, it is not completely sure that the PPT rule provides tax authorities new tool that they did not already had. Interpretations of treaties are always taken in accordance with the object and the purpose of the treaty.[201] The purpose of preventing double taxation was the primary purpose of the MTC, while the purpose of confronting tax avoidance was added to the commentary in 2003.[202] One would say that the PPT rule would enable tax authorities to confront arrangements which reflect an intention to achieve treaty benefit. However, an interpretation of the MTC in accordance to the principles provided by its Commentary will preclude the granting of treaty benefits not in accordance to those purposes. Hence, the existence (or non-existence) of an intention is not of an importance, since benefits in anyway will be given (or not) on the basis of compliance with the purposes of the treaty. In that regard, the PPT rule is merely a confirmation to the rule of interpretation of treaties in accordance with its purposes. [203] However, it is still very biased in favor of tax authorities as compared to other domestic GAARs and the GAAR provided by the ATAD.

3.5. The effectiveness of the PPT rule

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[198] Lang 2014, p. 660.
[199] Pinetz, p. 116-117.
[200] Lang 2014, p. 660.
[201] Vienna Convention on the Law of Treaties, Article 31, 23rd of May 1969.
[202] MTC, Commentary on Article 1, paragraph 7.
[203] Lang 2014, p. 661.

This sub-part will follow the method to evaluate the effectiveness of PPT rule presented in part 3.4, in which effectiveness of a GAAR is measured using two parameters: the degree of legal certainty that the GAAR under consideration provides, and its ability to confront abusive practices that otherwise resulted in unjustified lower tax burden without hindering free trade.

3.5.1. The influence of the PPT rule on legal certainty

As mentioned in sub-par 2.5.1, as a consequence of their nature as 'gap-fillers', GAARs do not provide for a lot of legal certainty compared to other tax anti-avoidance provisions, such as SAAR. However, there are certain elements that an inclusion of them in a GAAR would increase the degree of legal certainty. For example, the artificial requirement found at the GAAR provided by the ATAD that was discussed broadly in the CJEU case law. There are two main elements provided by the PPT rule that undermine the possibility of taxpayers to predict the tax consequences of their economic activities. The first one is the notion of 'principal purpose'. The second one is the 'reasonableness' standard of proof regarding the subjective element.[204]

The notion 'principal purpose' is not defined in the suggested Article provided by Action 6 ('entitlement of benefits') or at its suggested Commentary. It is clear that an arrangement might have more than one 'principal purposes', since the provision requires that the purpose will be 'one of the principal purposes' in order for it to apply. Hence, an interpretation saying that the 'principal purpose' of an arrangement is the most significant purpose as reflected by the facts and circumstances in not feasible. The Commentary provided by Action 6 conclude that the purposes of a targeted arrangement will be determined on a case-by-case basis, considering the relevant circumstances and facts, but does not provide for any guidance on differing between the purposes to be found.[205]

The suggested Commentary provide for 10 different examples that supposed to spill light on the expected function of the PPT rule.[206] However, it is not possible to extract any guidance on the interpretation of the term 'principal purpose'. Examples A and B are classic treaty shopping cases in which no purposes other than obtaining a treaty benefit was presented.[207] Examples C-I all providing cases in which a significant real business purposes was found, while the tax benefit is highlighted as ancillary.[208] The only example

[204] Eric Kemmeren, *Where is EU law in the OECD BEPS Discussion?*, EC Tax Review, 23(4) 190, p. 192-193, 4/2014. (Hereinafter: **"Kemmeren"**).
[205] Action 6, p. 58, paragraph 12.
[206] Action 6, p. 59-64, paragraph 14.
[207] Action 6, p. 59.
[208] Action 6, p. 60-63.

which gives a bit of clue is example J.[209] There, a clear business purpose existed (the construction of a factory), but it was taken in an abusive manner (dividing the construction contract in order to avoid of a PE starts following Article 5(3) of the MTC). However, the divided contract did not have any real substance, as opposed to the construction itself. The vague character of the notion 'principal purpose' is surely an obstacle to legal certainty that directly impact the effectiveness of the PPT rule.

The second element that undermine the legal certainty of the PPT rule is the 'reasonableness' burden of proof. Following the PPT rule, a treaty benefit shall be denied if it is reasonable to conclude from the circumstances and facts that obtaining that benefit was of a principal purpose of certain arrangement. Considering the fact that the BEPS Project as a whole does not distinguish clearly between avoidance, abuse, or evasion, 'reasonableness' is quite a low burden of proof.[210] Actually, asking tax authorities to base their decisions on 'reasonableness' only requires them to produce mere evidences showing that their decision is within a large scale of possible decisions.

'Reasonableness', of course, is not defined through Action 6, the MTC or its Commentary. In fact, it is a term that is mostly used in common law jurisdictions and connected to the legality of administrative decisions. The English courts applied a test of 'reasonableness' if an administrative decision was authorized by law, though still seemed unjust. [211] However, here the 'reasonableness' standard does not apply on the authority decisions, but it is the standard the authority should consider in denying treaty benefits. Moreover, the Commentary prior the recommendations of Action 6 already provide with a stricter standard of proof, where it states that contracting states should give relief of double taxation unless there is a 'clear evidence' for treaty abuse. [212] In conclusion, not only it is not certain what kind of impact the PPT rule might have, it also does not provide for a great deal of legal certainty as compared to other GAARs.

<u>3.5.2. The ability of the PPT rule to confront abusive practices otherwise resulted in treaty abuse without hindering free trade</u>

Unlike the GAAR provided by the ATAD, the PPT rule does not aim at general application in states' domestic tax legislation. Rather, it is merely recommended for application in bilateral tax treaties. Moreover, its impact on countries that currently use their domestic anti abuse legislation is questionable, since those countries might still use their domestic concept of abuse to tackle treaty abuse. However, as provided by sub-par 3.4.4, the PPT rule is biased in favor of tax authorities as compared to other GAARs,

[209] Action 6, p. 64.
[210] Cunha, p. 187.
[211] Cunha, p. 188.
[212] MTC, Commentary on Article 1, paragraph 22.2.

which might be an incentive for countries to apply the PPT rule's concept of abuse on treaty abuse situations. Hence, the examination of the ability of the PPT rule to confront abusive practices is concentrated in situations of treaty abuse only. Two examples that the suggested Commentary of Action 6 considered as situations in which the PPT rule applies will be used for the examination in this sub-part.

Example A: [213] TCo (resident of state T) owns shares of SCo (listed on the stock exchange of state S, hence LOB rule does not apply). There is no tax convention between S and T, and state S imposes withholding tax of 25% on dividends distributed by SCo to TCo. Following the tax treaty between R and S, S does not impose withholding tax on dividends distributed by its resident companies to shareholders which are residents of state R. TCo enters into an agreement with RCo (resident of state R) pursuant to which TCo assigns to RCo the right of a certain dividend payment by SCo that was already declared but have not yet been payed. Following the Commentary, this situation consists of treaty abuse which allowed the competent tax authority (here, state S) to deny the treaty benefit for RCo of no withholding tax on a dividend payment pursuit the tax treaty between R and S.

Actually, the PPT rule is not needed in order to confront this kind of treaty abuse. Article 10(2) of the MTC clarifies that the benefit of reduction in withholding tax in case of a dividend payment is pursuant to the receiver of the dividend being the dividend's 'beneficial owner'. According to the Commentary on Article 10, [214] where the receiver of the dividend acts as conduit for another person who in fact receives the concerned benefit (the reduction in withholding tax on dividend payment), the conduit receiver cannot be considered as beneficial owner and enjoy the benefit. That conclusion raises question regarding the need of the PPT rule, considering the extra burden it imposes on businesses.

In example A it was highlighted that no other purpose than the purpose of obtaining of the treaty benefit was found. Let us assume that in exchange to the right to receive the declared dividend distributed by SCo, RCo transferred to TCo a factory which is of the same accumulated value of the dividend. In addition, TCo currently has a cash flow problem and can only raise limited credit. If TCo would wait to the actual payment of the dividend, it will probably lose the opportunity to purchase the factory which was offered in a relatively low price. In this case, it is clear that other legitimate business purposes were of the basis of the arrangement between TCo and RCo. The Commentary on the PPT rule does not provide for any instructions on how to decide if the tax purpose, which in such a case could be considered ancillary, is one of the principal purposes of the arrangement. In my opinion, and due to the light standard of proof applied ('reasonableness'), if it seems that without the abolition of withholding tax the

[213] Action 6, p. 59, paragraph 14.
[214] MTC, Commentary on Article 10, paragraph 12.3.

arrangement would not have been taken, the subjective element will be fulfilled. However, the taxpayer (RCo) will have a strong argument regarding the objective element. The legitimate business purposes of such an arrangement are also crucial and without them the arrangement would not have been taking place. A denial of treaty benefits in this case will probably cause double taxation which is against the primary purpose of tax treaties, while the tax purpose is not the ultimate purpose of the arrangement. The outcome will probably be that the benefit will be granted, but the function of the PPT rule imposed an unjustified burden on the taxpayer. Such an excessive burden could have been prevented if the burden of proof of the objective element was relying on the tax authority.

Example J: [215] RCo's (resident of state R) bid for the construction of a power planet for SCo (resident of state S) in state S has accepted. The construction project is expected to last 22 months. According to Article 5(3) of the MTC, construction projects which last more than 12 months constitute PE status in the state where the project is taking place. According to this provision, the construction project in this example should constitute a PE status of RCo in state R, means RCo would be liable to tax on the profits attributed to this PE. RCo and SCo decided to divide the construction project into two different parts, each lasts 11 months. The first part will be conducted by RCo, while the second part will be conducted by SUBCO, a new 100% subsidiary of RCo recently incorporated in state S. Albeit the division of the contracts, RCo is liable for the performance of both contracts.

According the suggested Commentary of Action 6, the 'benefit' provided by Article 5(3) should be denied. First, it is not clear that Article 5(3) provides for a treaty benefit. Basically it is a rule that provide guidance on the concept of PE, in order to allocate business profits between contracting states. One could argue that Article 5(3) provide an extension to the duration of time normally needed to conclude that a PE status exists. However, it is possible that the constructing company would actually want for a PE status to exist, if the tax rate in the source state is lower than in the residence state, and the residence state exempt foreign source income. It must be borne in mind that the concept of PE follows a case-by-case approach, so even without Article 5(3) it is not evident that a construction project would be considered as a PE in every situation. Moreover, the Commentary on Article 5(3) concludes that the twelve-month test applies to each individual project, even if it consists of several contracts, which could render the application of the PPT rule senseless[216].

Similar to example A, example J also highlights the abusive behavior by not providing any possible business purposes for the division of the contract. Assume that SUBCO is a subsidiary which was formed

[215] Action 6, p. 64.
[216] MTC, Commentary on Article 5, paragraph 18.

to function as the destruction and excavation contractor of RCo. Large machinery designated for destruction and excavation contractors had been transferred to SUBCO by RCo. Moreover, in the construction contract it was agreed that the destruction and excavation procedures would take 11 months out of the 22. In such a case, legitimate business purposes are found alongside the alleged tax purpose. In my opinion, a clear answer to the occurrence of abuse in such a situation could have been easily provided had the PPT rule contained an artificial requirement. In such a case, if SUBCO did not engage in any other destruction or excavation operations and it was clear that its establishment was ad-hoc for a specific project, the arrangement would have been considered abusive.

In the absence of the artificial requirement, the sanction of the PPT rule would probably apply anyway. In case PE status would mean that RCo shall pay more taxes, it is reasonable to conclude that the division of the contract was for that purpose. The establishment of a PE status, which is the PPT rule sanction in this case, would not necessarily cause double taxation. Hence, RCo would find it difficult to prove that the denial of the 'benefit' in this case was in contrary to the purpose of the tax treaty. The outcome, in my opinion, is a non-proportionate broad application of the PPT rule. First, since the existence of a PE status (or non-existence) is not a pure benefit provided by the treaty, which may cause confusions as to the function of the provision. Second, a conclusion by which a certain arrangement is considered as treaty abuse is lightly assumed, which might hinder trade between the contracting states and undermine the purpose of tax treaties.

In both examples presented here it appears that the targeted abusive practice could have been eliminated without the PPT rule, even if the relevant state does not use domestic anti-abuse measures to confront treaty abuse. Moreover, the application of the PPT rule in its current version raises certain obstacles to taxpayers. The conduction of a treaty abuse is lightly assumed, and imposes high burden on a taxpayer who desire to escape from the sanction through the objective element. There is no link between economic substance and the occurrence of abuse, which makes it difficult to separate between legitimate and destructive arrangements. However, if the examination is purely regarding the ability of the PPT rule to confront treaty abuse, it is certainly effective. However, not only the vast majority of treaty abuses will fall into the scope of application of the PPT rule, it will probably confront legitimate arrangements too and hurt the overall effectiveness of tax treaties. In that regard, it is important that the competent tax authority will use its discretion in a proportionate manner. In my opinion, when combining those conclusions with the serious obstacles to legal certainty, it is not possible to conclude that the PPT rule is effective. Nevertheless, slight modifications to the PPT rule, as I suggest in sub-par 4.3.3, has the potential to increase its effectiveness considerably.

3.6. Conclusion

This chapter consists of an overview and analysis of the PPT rule that was recommended as part of a new 'entitlement of benefits' Article in the MTC. In order to evaluate the effectiveness of the PPT rule, this chapter began with an overview of the concept of tax avoidance as reflected by the MTC and its Commentary. I then discussed the reasons for engaging in the enormous BEPS Project, and the new approach of international tax law that was provided by it. This background explains the recommendation on the PPT rule, which gives a significant degree of discretion to tax authorities when acting against treaty abuse.

Treaty abuse is considered as one of the most harmful practices that causes BEPS. The original role of tax treaties has changed considerably along the years. At first, the ultimate purpose of tax treaties was to prevent international double taxation, a phenomenon that harms the free market and put constrains on international trade. Although the purpose of eliminating double taxation is still the primary purpose of tax treaties under the MTC, the amendment of the MTC Commentary in 2003 and the recommendations of Action 6 have considerably increased the importance of the purpose of confronting tax avoidance and abuse. However, the PPT rule consist of elements which grant excessive power to tax authorities, which might frustrate the primary purpose of the MTC and impose obstacles on free trade.

First, the formation of the PPT rule is clearly biased in favor of tax authorities on the expanse of taxpayers. The 'soft' burden of proof for tax authorities regarding the subjective element (reasonableness) as compared to the stricter burden for taxpayers regarding the objective element (to establish), and the lack of precise limitations on the discretion given to tax authorities are leading to that conclusion. Second, the PPT rule provide uncertainties regarding the manner it is about to apply. The most significant concerns in the light of legal certainty is the lack of definition to the notion 'principal purpose', and the 'reasonableness' standard of proof. Third, it seems like the PPT rule does not provide for any added value since a lot of the arrangements or transactions it targets could be confronted efficiently through the current provisions of the MTC and its Commentary. In conclusion, in order for the PPT rule to accomplish its original purpose of effectively confronting treaty abuse and to provide a decent degree of legal certainty, few modifications to the rule has to be made.

Chapter 4: A comparison between the PPT rule and the GAAR provided by the ATAD

4.1. Introduction

Chapters 2 and 3 contains an overview of the concept of tax avoidance on which each GAAR under consideration is based, an explanation of the reasons and aims that led to the application of each GAAR, and an analysis of the effectiveness of each GAAR. The initial aim of this chapter is to investigate and detect the conflicts arising from the different scope, aims, and formation of each GAAR under consideration. The chapter's second aim is to evaluate the possibility of coordinating in a legal situation in which both the PPT rule and the GAAR provided by the ATAD apply. In doing so, I consider the degree in which coordination issues further hamper the effectiveness of the GAARs as evaluated in sub-parts 2.5 and 3.5. The third aim of this chapter is to find solutions for the coordination issues and for the lack of effectiveness of the PPT rule.

In order to realize the practical conflicts that may arise between the PPT rule and the GAAR provided by Action 6, it is first important to understand the implication of EU law on tax treaties concluded by MSs. It has to bear in mind that while the GAAR provided by the ATAD is in fact a harmonized domestic GAAR that should replace the current GAARs found in MSs domestic legislation, the PPT rule is a GAAR suggested to be included in MSs tax treaties with other MSs and third states. In that regard, a preliminary question is to what extent MSs are free to conclude tax treaties with third states or with other MSs in terms of restrictions on EU fundamental freedoms? Hence, the first sub-par is devoted for an overview of the CJEU case law regarding the implication of EU law on provisions provided by tax treaties. Finally, I evaluate the compatibility of the PPT rule in case it was implemented in tax treaties of a MS.

In the second sub-par I analyze the practical differences between the PPT rule and the GAAR provided by the ATAD. In doing so, a special attention will be given to the lack of artificial requirement in the PPT rule, the different scope of the rules, the different burden of proof, and the literal disparities among the subjective and objective elements in both rules. After highlighting the expected conflicts between the PPT rule and the GAAR provided by the ATAD, I consider the coordination issues and their impact on effectiveness of both GAARs. In the last part I suggest modifications for the PPT rule that should eliminate the major conflicts between the PPT rule and EU law in general and the GAAR provided by the ATAD in specific, while enabling it to still reach its targets.

4.2. Tax treaties and EU law

As member countries of the OECD, MSs usually use the MTC as the basis for their bilateral tax treaties with other MSs and with third countries. Hence, in this chapter, the notion 'tax treaty' refers to a treaty

based on the MTC and its Commentary. In the lack of harmonization of the domestic tax laws of MSs, each MS has sovereignty to design its tax system according to its own circumstances and needs. This sovereignty also includes the freedom to negotiate with other countries on the allocation of taxing rights through tax treaties. However, the EU law does have a substantial impact on MSs towards the designing and functioning of their tax systems. Current positive integration in the field of direct taxation includes several directives that mentioned earlier in this research such as the PSD, the Mergers Directive, and the new ATAD. Nevertheless, those Directives do not include any specific provisions regarding tax treaties. In contrast to positive integration, the CJEU case law dealt with the issue of compatibility of tax treaty provisions with EU law extensively.

Similarly to the CJEU case law on the concept of tax avoidance that was reviewed through sub-par 2.2, the main concern of the CJEU in cases involving tax treaty provisions was possible restrictions on one of the EU fundamental freedoms, especially the freedom of establishment and the free movement of capital. In order to detect efficiently the practical conflicts between the PPT rule and the GAAR provided by the ATAD, it is important to understand the implication of EU law on MSs which considers including a PPT rule provision in their tax treaties. Hence, this sub-par includes an overview of the CJEU case law regarding the compatibility of tax treaty provisions with EU law. Further, I evaluate the compatibility of the PPT rule itself with EU law.

4.2.1. The CJEU case law on tax treaty provisions

The main purpose of tax treaties, as provided by the MTC Commentary is to prevent double taxation. An ancillary purpose of tax treaties is to confront tax abuse in general and treaty abuse in specific. That purpose is reflected, among others, by the recommendation to include the PPT rule as a provision in tax treaties. [217] Since tax treaties primary allocate taxing rights between countries, and only subsequently preventing possible tax abuse, it is important to understand the general application of EU law on tax treaties, and not only regarding treaty abuse situations.

Double taxation is caught as a harmful phenomenon that impedes obstacles on competition and free trade, hence disruptive towards the functioning of the internal market.[218] On the other hand, in the absent of harmonization towards the domestic tax system of MSs, each MS supposed to be sovereign regarding the manner it choose to confront double taxation. Article 293 of the EC treaty[219] (that was replaced by the TFEU) called MSs to negotiate with other MSs on the way to abolish double taxation within the internal

[217] MTC, Commentary on Article 1, paragraph 7.
[218] Lang, p. 30-31.
[219] Treaty establishing the European Community (Nice consolidated version), O.J. C 325, Article 293.

market. Surprisingly, this provision was not present in the TFEU, which did not prevent the CJEU from viewung the abolition of double taxation within the internal market as a goal of EU law.[220]

In its case law regarding the abolition of double taxation, the CJEU concluded that the obligation of MSs to prevent double taxation arises if it prevents double taxation in a comparable domestic situation.[221] However, it was also concluded that MSs are not obliged to use the same mechanism of prevention of double taxation in all situations. For example, the use of the indirect credit method for a certain situation, even when the exemption method was applied for other comparable situations was not considered as discrimination.[222] The rationale for that decision was that in the lack of any general obligation imposed on MSs to prevent double taxation (as long it does not discriminate in doing so), any internationally accepted method of abolishing double taxation is suffice (e.g. the methods provided by Article 23 of the MTC).[223] The fact that one method (e.g. the exemption method) may be more advantages to taxpayers in certain situations, does not necessarily means that in other situations the credit method would not be more beneficial for the taxpayer (e.g. for importing foreign losses). From an EU law perspective, all of the methods to eliminate double taxation are equal and the parallel use of them in different situations is not considered as prohibited discrimination, but the result from the exercise in parallel by two MSs of their fiscal sovereignty.[224]

If MSs are free to choose the method of eliminating double taxation, and tax treaties are merely functioning as a tool of allocating taxing rights between the contracting states, one would think that MSs are not limited by EU law regarding the provisions found in their tax treaties. However, the CJEU made it clear that the treaty freedoms are unconditional and may be invoked even if tax treaty provisions eliminate the general discriminative action followed by MS's domestic tax law. In the first generation of cases involved tax treaty provisions, MSs claimed that if a restriction on the freedom of establishment which was the consequence of certain domestic tax law was eliminated by a tax treaty provision, there is no restriction on the freedom of establishment. However, the CJEU more or less ignored the existence of

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[220] Terra & Wattel, p. 493-494.
[221] For example, Avoir Fiscal, paragraph 21.
[222] Case C-298/05 Columbus Container Services BVBA & Co. v. Finanzamt Bielefeld-Innenstadt, [2007] ECR-I 10497, paragraphs 39-40.
[223] Terra & Wattel, p. 495.
[224] Case C-513/04 Mark Kerckhaert & Bernadette Morres v. Belgische Staat, [2006] ECR I-10981, paragraphs 20-23. (Hereinafter: **"Kerckhaert-Morres"**).

a tax treaty for the purpose of examining the compatibility of the relevant domestic tax measure with EU law.[225]

That approach of the CJEU towards tax treaty provisions has changed considerably in subsequent case law. It seems like the CJEU realized that it is pointless to ignore such an effective international law regime such as tax treaties followed by the MTC. Moreover, the application of tax treaties affect the overall tax position of the taxpayer and may cause or eliminate prohibited discrimination by itself.[226] For example, an application of the PPT rule may prevent the granting of treaty benefits in a manner that will constitute a restriction on the freedom of establishment, if the PPT rule does not apply in comparable domestic situations. The CJEU started to use an overall approach, examining the combined application of domestic legislation and tax treaty provisions on the relevant case. However, the CJEU intend to not interpret tax treaties itself, and usually refer issues regarding the correct interpretation of tax treaty provisions to the relevant national court.[227]

The first landmark case in which the CJEU addressed directly provisions from tax treaties was the Gilly case. Mrs. Gilly was a teacher resident in France, which was employed by a German public school. She had nationalities of both Germany and France.[228] The French-German tax treaty, which was based on the MTC, provided different connecting factors for employment income. Eventually, the income from employment generated by Mrs. Gilly from working in the German public school was taxed in Germany. The reason is that following Article 14(1) of the relevant tax treaty, the German nationality of Mrs. Gilly was a decisive factor that enabled Germany to tax the employment income. The employment income was also taxed by France that was obliged to grant Mrs. Gilly a credit equal to the amount of the French tax imposed on the employment income. The German tax rate was higher than the French tax rate, which resulted in higher tax payment for Mrs. Gilly.[229] Mrs. Gilly claimed, among others, that the allocation of the employment income to Germany on the basis of her nationality (disregarding its French residency) that followed from the tax treaty between France and Germany is considered as a direct discrimination.[230] The CJEU concluded that MSs are sovereign to define the criteria for allocating their taxing rights. Hence, the choose of nationality as a connecting factor for taxation is not considered as discrimination,

[225] For example: Case C-204/90 Hanns-Martin Bachmann v. Belgian State, [1992] ECR I-00249, paragraphs 26-28.
[226] Terra & Wattel, p. 494.
[227] Kerckhaert-Morres, paragraph 23.
[228] Case C-336/96 Mr and Mrs Robert Gilly v. Directeur des Services Fiscaux du Bas-Rhin, [1998] ECR I-2823, paragraph 3. (Hereinafter: **"Gilly"**).
[229] Gilly, paragraph 11.
[230] Gilly, paragraph 12.

even if in other cases nationality is not used as a connecting factor for taxation.[231] The importance of the Gilly case was the overall approach taken by the CJEU towards the actual consequence of the application of tax treaty provisions. Instead of 'skipping' the tax treaty provisions and directly analyze the discriminatory effect of the domestic tax legislation, the CJEU included the consequences of the tax treaty provisions through its discrimination evaluation.[232] Eventually, this approach ensures that tax treaty provisions are in line with EU law.

Further evolution of the CJEU approach towards tax treaties conducted through the Saint-Gobain case. There, the CJEU ordered Germany to expand the scope of its tax treaties with third states in order to comply with EU law. Saint-Gobain is a company incorporated in France whose seat and legal management are located in France, and had a branch in Germany.[233] That branch was treated as a PE by German tax law, hence the French company was subject to limited tax liability in Germany on the branch's income and assets.[234] The branch received dividends from several EU and non-EU undertakings, including from an undertaking reside in the US. Following the Germany-US tax treaty, the US source income (the dividend) should be exempted by Germany.[235] However, Germany claimed that the Germany-US treaty does not apply, since the French company is not subject to unlimited tax liability in Germany. The Germany-US tax treaty applies only on persons or entities which are subject to unlimited tax liability in one of the countries. Hence, Saint-Gobain could not possibly be eligible for a treaty benefit such an exemption on US sourced dividends.[236]

The CJEU did not accept the German claim, and concluded that PEs of non-resident companies in Germany were treated less favorably then branches of resident companies without a suffice justification.[237]A justification on the basis of the lack of competence of the CJEU to intervene in bilateral tax treaties with third countries was dismissed, since the discriminative action was conducted unitarily by Germany.[238] There are two important principles provided by the Saint-Gobain case. First, it was cleared that MSs may not disregard EU law through their bilateral tax treaties. The fact that the field of direct taxation is not yet harmonized through the community does not allow MSs to ignore their commitment to

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[231] Gilly, paragraphs 29-31.
[232] Terra & Wattel, p. 500-501.
[233] Case C-307/97 Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt, [1999] ECR-I 6181, paragraph 3. (Hereinafter: **"Saint-Gobain"**).
[234] Saint-Gobain, paragraphs 4-5.
[235] Saint-Gobain, paragraph 17.
[236] Saint-Gobain, paragraph 16.
[237] Saint-Gobain, paragraph 64.
[238] Saint-Gobain, paragraph 55.

comply with EU law also through their tax treaty provisions.[239] Second, MSs may be obliged to grant treaty benefits provided by a treaty with a third state to non-resident taxpayers, even if it contradicts the provisions of the tax treaty itself.[240]

In conclusion, the allocation of taxing rights through bilateral tax treaties is part of the MSs sovereignty to design their tax systems. Situations in which taxpayers are exposed to double taxation due to the method of elimination of double taxation applied by a MSs is merely an outcome of the exercise in parallel of taxing powers and not considered as prohibited discrimination. However, that does not mean that MSs are free to discriminate against residents of other MSs or foreign capital through specific provisions provided by tax treaties. The examination of the suspect discrimination should take into account the consequences of application of a relevant tax treaty. In case an unjustified different tax treatment is given to comparable taxpayers due to the application of a tax treaty, the CJEU may order the competent MS to unitarily ignore certain provisions provided by that treaty in order to eliminate the prohibited restriction on EU fundamental freedoms.

4.2.2 The compatibility of the PPT rule with EU law

As follows from the case law described in sub-par 4.2.1, MSs are obliged to conclude their tax treaties in line with EU law. The CJEU is competent of taking into account the practical consequences of the application of a certain tax treaty when it evaluates the occurrence of an unjustified restriction on one of the EU fundamental freedoms.[241] In case a MS is in charge of an unjustified restriction on one of EU fundamental freedoms, the CJEU can oblige this MS to disregard certain provisions found in its tax treaties if these provisions are the cause of the restriction. The CJEU is also competent of committing a MS to unitarily expand the scope of application of tax treaties in order to eliminate a prohibited discrimination.[242] Since tax treaty provisions have to be compatible with EU law, it is important to evaluate the compatibility of the PPT rule with EU law in order to understand the possible conflicts that may arise in case of implementation of the PPT rule. It has to bear in mind that the EU concept of tax avoidance laid on concrete doctrines which provides for a decent degree of effectiveness in terms of legal certainty and ability to confront tax avoidance without harming free trade. The international concept of tax avoidance, as evaluated regarding the PPT rule in sub-par 3.5, is less effective, which raises questions regarding to its suitability for EU law atmosphere. In that regard, it is possible to point to several notions of the PPT rule that might impose obstacles on its compatibility with EU law.

[239] Saint-Gobain, paragraphs 57-58.
[240] Saint-Gobain, paragraph 59.
[241] Kemmeren, p. 193.
[242] Saint-Gobain, paragraph 59.

Following the PPT rule, tax treaty benefit will be denied if the achievement of this benefit was *"one of the principal purposes"* of the relevant arrangement or transaction. The Commentary on this notion explains that in order to decide if the granting of tax benefit was the 'principal purpose' of the arrangement or transaction, the relevant tax authority should objectively consider all the circumstances surrounding the arrangement in a case-by-case method. The competent authority should not look for a decisive proof that the principal purpose of an arrangement was the granting of tax benefit, and may conclude so if it is reasonable from all circumstances.[243] The EU law in that regard is not decisive. In some cases, mainly in the sphere of VAT[244] but also in the 2012 Commission Recommendation on aggressive tax planning,[245] the requirement was much stricter, using the phrase 'essential aim' which is narrower than 'one of the principal purposes' and might be problematic for EU law purposes.[246] However, in other EU law sources (e.g. the Cadbury Schweppes case, the PSD) the notion used was 'one of the main purposes', which is not substantially different than 'one of the principal purposes', which decreases the possibility of contradiction to EU law. Moreover, in the Mergers Directive, the relevant notion of the GAAR is 'one of the principal purposes', which is exactly corresponding with the relevant notion provided by the PPT rule.[247] It is more likely that the notion 'principal purpose' is not substantially different from the notion 'main purpose', and that the standard of 'principal purpose' was already recognized by the MTC commentary on Article 1.[248] Considering all of the above, the notion 'principal or one of the principal purposes' provided by the PPT rule's subjective element is probably in line with EU law.

A clearer deviation of the PPT rule from EU law is reflected by the burden of proof. The PPT rule provides that the granting of treaty benefit by itself is not in accordance with the purpose of the tax treaty unless provided otherwise. It follows from the literal form of the PPT rule, since the granting of the treaty benefit will almost always be at least one of the 'principal purposes' of an arrangement or transaction.[249] Only afterwards, the taxpayer may prove that *"the granting of that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this convention"*. That

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[243] Action 6, p. 57-58, paragraph 10.
[244] For example: Part Service, paragraph 29. Halifax, paragraph 75.
[245] Commission Recommendation 2012, Article 4.2.
[246] Kemmeren, p. 192.
[247] Ana Paula Dourado, *Aggressive Tax Planning in EU Law and in the Light of BEPS: The EC Recommendation on Aggressive Tax Planning and BEPS Actions 2 and 6*, Intertax Vol. 43 Issue 1 42, p. 56, 2015. (Hereiafter: **"Dourado 2015"**).
[248] Dr. Christiana HJI Panayi, *The Compatibility of the OECD/G20 Base Erosion and Profit Shifting Proposals with EU Law,* IBFD bulletin for international taxation 95, p. 108, January/February 2016. (Hereinafter: **"Panayi"**).
[249] Panayi, p. 109.

conclusion is clearly reflected by the Commentary on the PPT rule.[250] The substantial consequence of this notion is the transfer of the burden of proof to the taxpayer, which might be considered as not proportionate and beyond what is necessary.[251] However, the CJEU accepted such a transfer of the burden of proof in cases of payment between related parties which was not in arm's length.[252] The difference is that the fact that a payment between related parties is not in arm's length is a strong evidence for the conduction of artificial activity in the purpose of avoiding taxes. The artificial nature of the payment itself justifies the transfer of burden of proof[253]. In my opinion, an automatic transfer of the burden of proof is not proportionate to the aim of confronting tax avoidance and shall be considered incompatible with EU law.

Another risk of incompatibility with EU law which is connected to the sphere of proportionality is the total denial of treaty benefits in case the PPT rule applies. Following the PPT rule and its Commentary, there is no reference to situations in which it will be only justified to deny part of the treaty benefit. Sometimes, an entire denial of the benefit has the outcome of excessive sanction on amounts that were not included in the abusive arrangement.[254] In Thin Cap, the CJEU concluded that in order for an anti-abuse measure to be considered proportional and not going beyond what is necessary, the sanction should be in accordance to the abusive activity. There, it was decided that only the amount of interest that exceeds the arm's length payment should be reclassified as non-deductible dividend.[255] However, the option to deny only part of the benefit not found in the GAAR provided by the PSD too. Hence, it is possible that the judgment in Thin Cap only referred to cases in which payments between related parties are not in arm's length.[256]

Another major incompatibility with EU law is caused by the absence of artificial requirement in the PPT rule, a requirement that was consistently kept in every EU source of law regarding anti-avoidance measures. In other words, there is no reference for economic substance as a guideline to the existence of tax abuse or avoidance.[257] The objective analysis suggested by the Commentary on the PPT rule does not provide for any possibility to escape from the sanction of the provision through proving the existence of economic reality. It has to bear in mind that the artificial requirement is a core component of the EU

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[250] Action 6, p. 54, paragraph 2.
[251] Dourado 2015, p. 56.
[252] Thin Cap, paragraph 83.
[253] Thin Cap. Paragraph 81.
[254] Philip Baker, *The BEPS Action Plan in the Light of EU Law: Treaty Abuse*, British Tax Review Vol. 3 408, p. 414, 2015. (Hereinafter**: "Baker"**).
[255] Thin Cap, paragraph 82.
[256] Baker, p. 414.
[257] Dourado 2015, p. 56.

concept of tax avoidance, and a leading principle that form a direct connection between the deviation from economic reality and the occurrence of tax abuse that need to be confronted.[258] It is not surprising that the main concern of the EU Commission regarding the PPT rule, as reflected in the Commission's Treaty Recommendation, was the absence of artificial requirement.[259]

The last possible deviation of the PPT rule from EU law is based on the principle of legal certainty. As mentioned in sub-par 2.5.1.1, anti-abuse provisions are considered as meeting the EU principle of legal certainty only if they are clear, precise and predictable as regards their effect. In case the application of an anti-abuse provision may have unfavorable consequences for taxpayers (as in the case of application of the PPT rule) the requirement of legal certainty should be even stricter. In previous case law the CJEU concluded that the term 'special relations'[260] for interest limitation rule purposes and the term 'more advantageous tax regime'[261] are not sufficiently precise in order to fulfil the proportionality requirement. The main flaw that risks the compatibility of the PPT rule with the principle of legal certainty is its standard of proof – reasonableness. One would say that this standard of proof is not recognized by EU law, and in any way it is not precise enough to enable taxpayers to predict the outcome of their economic activities.[262] The answer to the legal certainty question is dependent on the practical manner of implementation and interpretation of the PPT rule by the adopting MS.

In conclusion, the accumulation of so many deviations between the PPT rule and EU law reflects a real possibility that in case a MS will conclude the PPT rule in its tax treaties, it will be incompatible with EU law. However, that possibility was foreseen by the authors of Action 6. In fact, a direct reference to MSs was made, recognizing that some of the recommendations of Action 6 might be restricted by EU law.[263] In that regard it has to bear in mind two facts. First, the recommendations of Action 6 were taken according to the minimum standard approach. That means that countries are not expected to literally implement all of the recommendations of Action 6, but to make a clear statement on their intention to confront the phenomenon of treaty abuse in general and treaty shopping in specific.[264] Second, the PPT rule is mainly meant to be a complementary tool for countries that cannot use their domestic anti-abuse provisions for treaty abuse cases. Hence, the perception was that while domestic GAARs (based on the GAAR provided by the ATAD) have to be in line with EU law, the PTT rule is merely used in clear treaty

[258] Panayi, p. 109.
[259] Commission's Treaty Recommendation, p.3.
[260] Itelcar, paragraphs 43-44.
[261] SIAT, paragraphs 56-57.
[262] Kemmeren, p. 192.
[263] Action 6, p. 14, paragraph 6.
[264] Action 6, p. 19-20, paragraphs 21-23.

abuse situations. Hence, it is expected that the CJEU will be more tolerant regarding judicial intervention due to the incompatibility of such a rule with EU law.[265]

4.3. Conflicts and coordination between the GAAR provided by the ATAD and the PPT rule

This sub-par provides a comparison between the features concluded by the GAAR provided by the ATAD and the PPT rule. The aim of this comparison is to detect the elements that cause the conflicts between both rules. After pointing on the substantive differences between both rules, I try to evaluate the coordination issues that may arise in case of implementation of both rules by a MS. For the purpose of the practical analyze, attention will be given to the possibility that the PPT rule is not in line with EU law, as reflected by the analysis of sub-par 4.2.2. In the last sub-part of this research I suggest modifications to the PPT rule that in my opinion, supposed to moderate the conflicts between the PPT rule and EU law and with the GAAR provided by the ATAD. The purpose of the suggested modifications is to contribute for the application of the PPT rule in the EU sphere in a coordinative manner while not materially frustrating its ability to confront treaty abuse.

4.3.1. The differences between the GAAR provided by the ATAD and the PPT rule

As indicated in the Introduction Chapter of this research, one of the main purposes of the ATAD is to ensure the unified implementation of the BEPS Project recommendations by MSs. Eventually, the GAAR provided by the ATAD is substantially different from the PPT rule. This sub-part highlights the differences which are found through all of the elements of both rules. The aim of this comparison is to detect differences between the GAAR provided by the ATAD and the PPT rule in order to understand what coordination issues may arise in case of parallel implementation of both rules and its affection on the effectiveness of the rules.

The first deviation, which is the consequence of the different scope of both rules, is the sanction provided in case of application of the provision. The sanction provided by the PPT rule is the denial of the treaty benefit that it's granting was the aim of the arrangement, while the sanction in case of application of the GAAR provided by the ATAD is re-calculation of the corporate tax liability. This difference is inherent to the character of both rules. The GAAR provided by the ATAD is meant to function as a domestic anti-abuse measure which affects the ultimate tax liability of the taxpayer, and the PPT rule functions as a treaty anti-abuse measure which only applies on cases under the scope of the relevant tax treaty. Both approaches have meaningful disadvantages which attracted criticism.

[265] Dourado 2015, p. 57.

The sanction provided by the PPT rule raises two main concerns. First, it is not clear if the 'denial of benefits' means an entire denial of the relevant treaty benefit in any case, or does the denial correspond to the exact amount which reflects the abuse (e.g. the entire denial of the reduced rate for withholding tax on interest payment made through conduit arrangement, or a denial which is limited to the amounts paid through the conduit arrangement, if there were other legitimate interest payments).[266] The second concern related to the type of benefits which are included in the scope of the sanction. Following the Commentary on the PPT rule[267] it seems like the scope and definitions Articles of the MTC does not provide for any benefits, which increases the vagueness of the impact of the sanction.[268] The sanction applied by the GAAR provided by the ATAD has one main disadvantage. It is not clear if the re-classification also covers the imposition of withholding taxes. In some MSs withholding taxes are not considered as part of the regular corporate tax income, which might lead those MSs to not apply the GAAR provided by the ATAD in case of tax abuse related to withholding taxes.[269] In that regard, it has to bear in mind that the calculation of tax liability should be done in accordance with domestic law, so such an interpretation is not far-reaching.[270] Anyhow, this lack of certainty might cause further conflicts and disparities between the rules, even though their scope is clearly different. For example, some countries might apply the standard provided by the PPT rule on cases involving withholding taxes between MSs since they think the GAAR provided by the ATAD is not covering it, which might cause a breach of EU law.

Another source for differences between the PPT rule and the GAAR provided by the ATAD is the subjective element. When looking at the subjective elements of both rules, it is possible to point out on three spots of deviations. The first one, which actually causes no real conflict, is the differentiation between the terms which set the material requirement of the tax purpose found to exist in the targeted arrangement. The PPT rule requires that *"one of the principal purpose"* of the arrangement was obtaining a treaty benefit, while the GAAR provided by the ATAD requires that the *"main purpose or one of the main purposes"* was obtaining a tax advantage. As analyzed in sub-par 4.2.2, there is no substantive difference between those requirements. Moreover, the GAAR provided by the Mergers Directive follows the term provided by the PPT rule, means that the EU Commission see the notions 'principal purpose' and 'main purpose' as equivalent.[271] It will be reasonable to conclude that on this issue the EU Commission followed the BEPS Project, since in the commission recommendation on aggressive tax

[266] Baker, p. 414.
[267] Action 6, p. 56, paragraph 7.
[268] De Broe & Luts, p. 131.
[269] Rigaut, p. 503.
[270] Navarro, Parada and Schwartz, p. 15.
[271] Panayi, p. 108.

planning[272] and in the first proposal of the ATAD[273] the relevant notion used was the 'essential purpose' which is narrower of both the notions eventually adopted.

A meaningful deviation is caused due to the different target of the abusive behavior in both rules. The PPT rule requires that the targeted arrangement's purpose was the obtaining of a treaty benefit, while the GAAR provided by the ATAD requires that the targeted arrangement's purpose was the obtaining of a tax advantage. In assent, the PPT rule deny treaty benefits merely because one of the principal purposes of a certain arrangement, possibly among other positive economic purposes, was the obtaining of a treaty benefit. This provision has the potential to undermine the basic and most important purpose of tax treaties – to eliminate double taxation in order to advance the free market.[274] Taxes are a meaningful factor in the decision making processes of a business, and the entire exclusion of tax motives from businesses considerations is an overkill regarding the aim of preventing treaty abuse. In contrast, the GAAR provided by the ATAD does not hold in any presumption regarding the occurrence of abusive behavior due to mere tax purposes.[275] In fact, the CJEU case law which is the basis for the GAAR provided by the ATAD concludes exactly the opposite. The mere fact that a taxpayer enjoyed a tax advantage,[276] or deliberately enjoyed the benefit of a low-tax regime,[277] can not constitute an abuse. Even payments of interest on loans to undertakings subject to a low tax regime do not constitute an abuse if the payments were in arm's length.[278] Consequently, the PPT rule will cover situations that would not be considered as abuse through the GAAR provided by the ATAD, and that conclusion is even prior of taking into account the artificial requirement, which leads to the next major deviation.

As described in sub-par 2.2, the artificial requirement has been discussed constantly in the CJEU case law on tax avoidance and was adopted through several recommendations of the EU Commission. In the heart of this discussion was the establishment of a link between (the lack of) economic substance and the abusive behavior.[279] Following the Cadbury Schweppes case, in order for a restriction on the freedom of establishment to be justified on the basis of the need to confront tax avoidance, the relevant measure should target only: *"wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due"*.[280] That strict requirement was lightened in the Thin Cap case, where an

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[272] Commission Recommendation 2012, Article 4.2.
[273] ATAD Proposal, Article 7.
[274] De Broe & Luts, p. 132.
[275] Dourado 2015, p. 56.
[276] Cadbury Schweppes, paragraph 36.
[277] Eurowings, paragraph 45.
[278] Thin Cap, paragraph 73.
[279] Dourado 2015, p. 52.
[280] Cadbury Schweppes, paragraph 55.

interest payment to a foreign connected party was considered as forming an abusive practice solely because the payment was not in arm's length.[281] However, the decision in Thin Cap did not break the connection between economic reality and abusive practices, since the fact that a payment between connected parties was not in arm's length is considered by itself as not reflecting economic reality. This strong connection to economic reality is reflected in the GAAR provided by the ATAD through the requirement for the targeted arrangement to be 'non-genuine', meaning that the arrangement *"not put into place for valid commercial reasons which reflect economic reality"*. The consequence of the artificial requirement is that the competent tax authority, when applying a GAAR such as the GAAR provided by the ATAD, should focus only on arrangements which are materially lacking of economic purposes and substance.

In contrast, the PPT rule does not require the targeted arrangement to be of any artificial nature in order for the provision to apply. Consequently, when combining this fact with the circulative effect provided by the subjective element of the PPT rule, the result is that legitimate economic business purposes, even substantial ones, cannot prevail over a tax purpose which is substantive by itself in order to preclude the application of the provision.[282] This conclusion is clear from the Commentary on the PPT rule.[283] The example provided there concludes that if a person who has business purposes in selling his assets is becoming a resident of a certain state for tax treaty reasons before selling the assets, his actions will be considered abusive and will lead to the application of the PPT rule irrespective of the existence of business purposes. Such a situation will probably not lead to the application of the GAAR provided by the ATAD, since this certain arrangement will not qualify the artificial requirement.

At first sight, it seems like the objective elements provided by both rules do not deviate considerably. The GAAR provided by the ATAD requires that the granting of the relevant tax advantage *"defeats the object or purpose of the applicable tax law"*, while the PPT rule concludes that the provision would not apply if the benefit was granted *"in accordance with the object and purpose of the relevant provisions of this convention"*. However, deviations are found regarding the relevant legislation that should be analyzed and regarding the general functioning of both objective elements. While the purposes of the MTC are clear and recognized through the MTC Commentary (the prevention of double taxation in order to advance free trade as primary purpose, the prevention of tax abuse as secondary purpose), the objective element of the GAAR provided by the ATAD refers to the applicable (in most cases, national) tax law. First, that reference to national law frustrates the harmonization process which was one of the purposes of

[281] Thin Cap, paragraph 81.
[282] Vanistendael, p. 169.
[283] Action 6, p. 58, paragraph 13.

the ATAD. Second, such a reference might cause issues due to the interpretation which will be given to the purposes of the relevant tax law. A national court may conclude that tax rules have no purpose other than raising revenues to finance the country budget. Such a conclusion will make the objective element of the GAAR provided by the ATAD senseless, since lowering the country's treasure will always be contrary to the purpose of tax laws.[284] However, in my opinion, such an interpretation is far reaching.

The more important deviation between the objective elements of both rules is their functioning. The functioning of the objective element found in the GAAR provided by the ATAD is clear and was conducted in many cases of the CJEU regarding the concept of tax avoidance. The competent tax authority should consider the compatibility of the achievement of the relevant tax advantage with the purpose of the relevant tax law (or fundamental freedom) as part of its general consideration regarding the application of the provision (together with the subjective element and the artificial requirement).[285] In contrast, the functioning of the objective element found in the PPT rule is not so clear and leaded to different opinions by scholars on the ground of its affection on the burden of proof.

A possible interpretation to the term *"it is established that granting the benefits in this circumstances"*, which settle the application of the objective element in the PPT rule, is that the objective element merely function as an exception. If considering that the PPT rule by itself is an exception, the objective element is an exception from the exception, hence just confirming the general rule which does not need to be interpreted narrowly (as usually exceptions are interpreted). Following that interpretation, the objective element is not functioning as a defensive element for the taxpayer, but merely expanding the power of tax authorities that should consider the objective element after they find the existence of abuse, and not as part of that conclusion.[286] If this is the correct interpretation, the deviation between the objective elements provided by both rules is not substantial.

Another possible interpretation says that once the tax authority can 'reasonably' conclude that the subjective element is fulfilled, the burden of proof is shifted away to the taxpayer to establish that the benefit was granted in accordance with the purpose of the tax treaty.[287] This kind of interpretation leads to a complete deviation between the objective elements of both rules by providing tax authorities with much more power under the PPT rule than under the GAAR provided by the ATAD.[288] The differentiation of the burden of proof is even greater due to the standard of proof required by tax authorities when applying

[284] Navarro, Parada and Schwartz, p. 15.
[285] For example: Cadbury Schweppes, paragraph 64. Halifax, paragraph 57.
[286] Lang 2014, p. 660.
[287] Panayi, p. 109.
[288] De Broe & Luts, p. 132.

the PPT rule. The standard of proof is 'reasonable', a standard which is not recognized through EU tax law.[289] It is impossible to conclude which of the interpretations is the correct one through the Commentary on the PPT rule, since the examples given there are neutral towards both interpretations.[290] In my opinion, which is supported by larger number of scholars who wrote on that issue, a literal interpretation of the objective element leads to the conclusion that the burden of proof is shifted to the taxpayer who can escape from the application of the provision through the objective test.

In conclusion, a lot of meaningful deviations are found between the PPT rule and the GAAR provided by the ATAD. The most important deviations that may provide conflicts in the future is the lack of artificial requirement in the PPT rule, the different standard of proof, and the possible shift of the burden of proof regarding the objective element. Generally, it seems like the PPT rule provide substantial extra power to tax authorities than the GAAR provided by the ATAD. That conclusion is reasonable taking into account the different tax avoidance concepts on which those two rules are based. These differences are not only theoretical and will probably result in coordination issues in case of parallel application of both rules, as will be demonstrated in the next sub-part.

4.3.2. Coordination between the PPT rule and the GAAR provided by the ATAD

Before analyzing the possible conflicts that may arise in case of parallel application of both rules, it has to bear in mind the different scope and aims of both rules. While the GAAR provided by the ATAD is about to be implemented in MSs domestic legislation and has a general scope on all corporate tax matters, the PPT rule is meant to be implemented in bilateral tax treaties with limited application to taxpayers which are covered by the treaty. Moreover, the authors of Action 6 recognize the fact that the vast majority of states in the world already have a domestic GAAR, and separate between two types of states: states which consider treaty abuse as abuse of the national law itself and apply their domestic GAAR on treaty abuse situations, and states which considers treaty abuse as abuse of the treaty itself, which prevents them of applying their domestic GAAR on treaty abuse situations. Following Action 6, albeit the PPT rule is recommended as a new provision in the MTC, the BEPS Project respects the supremacy of domestic GAARs in case of states which uses their domestic GAAR to confront treaty abuse. It follows, that the PPT rule is only complementary for occasions where such a domestic GAAR is absent or cannot apply. However, that does not mean that only states of the first type will include the PPT rule in their tax treaties. That might happen, for example, if the other contracting state insists to include the PPT rule in a treaty since it is a state of the second type. In case the relevant state is a MS, it will have to choose if applying

[289] Cunha, p. 189.
[290] See: Action 6, p. 60-64, paragraph 14, examples C, E and I.

the 'aggressive' standard of tax avoidance provided by the PPT rule, or 'soft' standard of tax avoidance reflected through the GAAR provided by the ATAD. The existence of two different standards of tax avoidance through the EU inherently raises coordination issues that may affect the functioning of both rules.

The main concern regarding the conflicts between the PPT rule and the GAAR provided by the ATAD is a consequence of the major differences found between those rules. The lack of artificial requirement in the PPT rule and the shift of the burden of proof regarding the objective element have the result of a bias in favor of tax authorities as compared to the GAAR provided by the ATAD. The application of the PPT rule in certain situations and not the GAAR provided by the ATAD might be considered by itself as a discriminative treatment by EU law. When adding this conclusion to the possibility that the PPT rule probably contradicts EU law, as provided by sub-par 4.2.2, the result is a major insensitive for MSs to refrain from adopting the PPT rule in their tax treaties. However, an insensitive in favor of adopting the PPT rule is the fact that such a rule gives tax authorities greater means to confront treaty abuse as compared to the GAAR provided by the ATAD. It has to bear in mind that the MTC and its Commentary were recognized as effective and legitimate sources of international law by the CJEU itself. Hence, such a conclusion by which a provision that found in the MTC is not in line with EU law has a potential to impact on the general legitimacy of the MTC and would not be made easily.

The following example (with interchangeable facts) is the basis of the examination in this sub part: Company A, which is an active company, has undertakings in Company B which resides in a MS. This MS has concluded a tax treaty with another state by which a resident of that other state receives dividends from a company which resides in that MS, will not be liable of withholding tax on that dividend. Company A wanted to shift its activities and residency to that other state for a long time, because of legitimate business reasons such as the market facilities in that state and higher predicted profits. Another reason for residing in that other state is the announcement of dividend payment by Company B to take place in few months. The fact that Company A resided in that other contracting state provides Company A the benefit of elimination of dividend withholding tax when the dividend was distributed. Following the PPT rule, the tax purpose of residing in that other state is considered as treaty abuse and enables the MS to deny the treaty benefit. According to the GAAR provided by the ATAD, the legitimate business reasons to the relocation of Company A preclude the abolishment of the tax advantage.

Case 1: the MS concluded a tax treaty with a third state that includes a PPT rule. Company A was incorporated under the laws of another third state, and moved entirely to the third state which concluded the treaty with the MS. In this case, both the PPT rule (provided by the treaty) and the GAAR provided by

the ATAD may apply. The MS will probably want to apply the PPT rule since it provides its tax authority more powers, which would lead to denial of the tax benefit and imposition of withholding tax. It can be justified by the prevalence of treaty provisions over conflicted domestic provisions. Company A would not be able to claim for restriction of a fundamental freedom since it is not eligible to such freedoms except of the free movement of capital, which is not restricted in this case. Where there is no concern of a breaching of EU fundamental freedoms, the coordination issue between the PPT rule and the GAAR provided by the ATAD is insignificant. In this case the taxpayer has no legitimate claim to justify an application of the GAAR provided by the ATAD and not the PPT rule. In conclusion, the existence of differences between the PPT rule and the GAAR provided by the ATAD does not create major conflicts between the rules when the other contracting state is a third state, and the relevant taxpayer is not eligible to EU fundamental freedoms.

Case 2: the MS (MS A) concluded a tax treaty with a third state that includes a PPT rule. Company A was incorporated in another MS (MS B) and was relocated in the contracting third state. According to the PSD, Company A should be granted a benefit of no withholding tax on dividend distributions since it is still considered as resident in MS B. However, MS A believes that Company A does not eligible to the PSD benefits since the tax treaty between MS B and the contracting third state concludes that company A is resident of the third state for tax purposes. MS A chooses to apply the PPT rule and not the GAAR provided by the ATAD and justify it by treaty override. Company A can claim that the fact that the treaty tie-breaking rule excludes it from application of treaties concluded by MS B does not exclude its eligibility to Directive benefits. However, it is hard to see a path in which Company A would be able to prove the existence of a restriction on one of its fundamental freedoms, since it was not relocated inside the EU but outside the EU, so that situation is not comparable to a domestic relocation. Similarly to Case 1, a coordination issue will not arise unless the relevant taxpayer has valid claim by which the EU concept of abuse shall apply and not the concept provided by the relevant tax treaty.

Case 3: MS A concluded a tax treaty with MS B that includes the PPT rule. Company A was incorporated in MS C, and following the tax treaty between MS A and the MS C, MS A may impose withholding tax of 15% on the dividend distribution of Company B. Company A relocates to MS B which concluded a tax treaty which includes the PPT rule and no withholding tax on dividends sourced in MS A. MS A choose to apply the PPT rule regarding the distribution of the dividend and not the GAAR provided by the ATAD and justifies it by treaty override reasons. The outcome of applying the PPT rule is a denial of the treaty benefit and imposition of 15% withholding tax due to the application of the tax treaty between MS A and MS C (for the purpose of this example, Company A is not eligible of PSD benefits).

This situation involves major coordination issue between the PPT rule and the GAAR provided by the ATAD. Company A can claim that in a pure domestic situation (e.g. Company A resided in one city in MS B and moved to another city in the MS B) the PPT rule would not have applied, since no extra tax benefit was provided. Hence, a restriction on the freedom of establishment may arise that should be justified by overriding reasons of public interest. Another path to claim for a restriction on EU fundamental freedoms follows the fact that MS A treat differently companies from different MSs by applying the PPT rule in places it is provided by a treaty, and applying the GAAR provided by the ATAD in places where such a tax treaty is absent. Such discrimination is another restriction on the freedom of establishment that should also be justified by overriding reasons of public interest. When examining those discriminations with the justification of the need to confront tax avoidance, few issues arises. First, the measure does not target only wholly artificial arrangements and in fact does not require any artificial nature. Second, the entire denial of benefits and the flip of burden of proof will probably consider as not proportionate and measures that goes beyond what is necessary. Eventually, a measure such as the PPT rule could not be justified by the need to confront tax avoidance when it discriminates EU companies because of the conflicts that arises between the PPT rule and the GAAR provided by the ATAD.

Following the conclusion of Case 3, it is hard to predict which concept of tax avoidance should apply in purely European situations. That uncertainty has a crucial importance especially regarding GAARs. It has to bear in mind that GAARs by their nature do not provide for a lot of legal certainty. Here, not only the taxpayer is not sure if his actions will be confronted through the relevant GAAR, he does not even know which of the GAARs is the relevant one. The field of direct taxation is not a harmonized field, and MSs will probably have different approaches regarding the GAAR it will choose to apply in each case. The impact of this coordination issue is substantial due to the large amount of deviations between the GAAR provided by the ATAD and the PPT rule. The predicted consequence of this deviation is a different outcome to comparable cases in major amount of situations. The result of this coordination issue is an increasing erosion of the legal certainty provided by both rules which lowers the effectiveness of them. There could be two solutions to this situation. First, through positive integration which provide clear tie-breaking rule for MSs when they decide which GAAR they should apply. However, following the different opinions MSs have regarding direct taxation issues it is hard to see a quick agreement which will eliminate that coordination issue. Second, it is possible to modify one of the rules in a way that no major difference in treatment will longer exist between them. In my opinion, since the GAAR provided by the ATAD is based on a coherent concept of tax avoidances and proven to be more effective than the PPT rule, the modifications should be made to the PPT rule.

In conclusion, as expected following the major differences between the PPT rule and the GAAR provided by the ATAD, some taxpayers will be able to argue for a discrimination when applying the PPT rule in situations that would not have resulted in a sanction if the GAAR provided by the ATAD would of apply. The main issues concern mainly purely EU situations, while situations involving third states impose less of a risk. In order for the PPT rule to achieve its aim which is to confront treaty abuse effectively, it cannot impose such legal risks on all of the MSs, which are considered as very influential countries in the OECD and are the leading countries in respect of the adoption of the MTC. Hence, the next sub-part is devoted to some suggestions to modifications of the PPT rule that, in my opinion, will eliminate the major conflicts that arise between the PPT rule and the GAAR provided by the ATAD in specific, and with EU law in general.

4.3.3. Suggestion for modifications to the PPT rule

As described in this chapter, the PPT rule in its current formation raises major concerns regarding its compatibility with EU law and regarding the differentiation between it to the GAAR provided by the ATAD, which raises coordination issues that frustrates the effectiveness of both GAARs. These concerns might prevent MSs from adopting the PPT rule in their tax treaties, which might deprive the PPT rule from achieving its purpose – to effectively confront treaty abuse. Hence, in this sub-part I recommend on three modifications to the PPT rule that would allow MSs to adopt it without concerning its comparability with EU law and coordination issues.

The first suggested modification relates to the most obvious difference between the PPT rule and the GAAR provided by the ATAD, which is the lack of artificial requirement. The artificial requirement was recognized as the basis for all of the GAARs provided by the different EU Directives – the PSD, the Mergers Directive, and of course the ATAD. The artificial requirement is also provided by the vast majority of domestic GAARs around the world, and especially among MSs. It is a fundamental requirement that was settled in many direct taxation cases dealt by the CJEU. Most importantly, the artificial requirement provides with a direct connection between economic reality and tax avoidance. Without it, tax authorities have a lot of power to interrupt the regular business atmosphere and prevent from legitimate business activities to take place. The lack of artificial requirement had already raised concerns with the EU Commission that recommended MSs to apply a different version of the PPT rule which includes an artificial requirement. In my opinion, an additional artificial requirement is necessary for the PPT rule to be accepted by many countries, and especially by MSs. Without it, it is impossible to ascertain when the tax authority will change your tax results, which could restrict positive performance. Hence, the introduction of an artificial requirement to the PPT rule is crucial for its success.

The second modification that I suggest is modification of the objective element of the PPT rule. Currently, it is not clear if the objective element functions as an exception to the rule that should be considered by the tax authority, or whether it is a 'defensive' argument that can rescue the taxpayer from the sanction of the provision. Other than the need of clarity and the risks to legal certainty that arises due to this situation, it is just far reaching to conclude that a treaty abuse was conducted following solely the subjective element. In my opinion, the PPT rule should be clear in that regard and conclude that the objective element is part of the competent tax authority considerations when it decide if applying the provision. Moreover, it is much more logic for the taxpayer to use proofs of valid economic reasons through the artificial requirement in order to escape from the application of the provision than require him to conduct a legal analysis regarding the purposes of his actions and the purposes of the relevant tax treaty.

My third and last suggestion relates to the standard of proof. Following the subjective element provided by the PPT rule, the tax authority can deny the relevant treaty benefits if it seems 'reasonable' to her that one of the principal purposes of the arrangement was obtaining that benefit. This standard of proof raises three main concerns. First, it is impossible for the taxpayer to ascertain what would seem 'reasonable' to the tax authority. Such an unpredicted standard of proof will be probably considered as not in line with the principle of legal certainty as follows from the CJEU case law. Second, the term 'reasonable' is mainly used in administrative law doctrines of common law systems. It is a weird notion to be applied in the field of direct taxation, especially through continental Europe. Third, It has to bear in mind that although tax avoidance does not constitutes a criminal felony, it follows with shame and disgrace if found to exist. Hence, it is important to ensure that the standard of proof would not be easily founded.

In case the three modifications I recommended on will be adopted, the PPT rule should be formulized as follows:

"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 <u>obvious</u> , 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, <u>it was established</u> that granting that benefit in these circumstances would not be in accordance with the object and the purpose of the relevant provisions of this convention, <u>and the arrangement or transaction does not reflects a genuine economic activity</u>."*

Such a provision will probably be in accordance with EU law and does would impose any major conflicts with the GAAR provided by the ATAD. Moreover, the decision which concept of tax avoidance should

apply would not be material any more. Hence, the coordination issues that decreased legal certainty in both GAARs and damaged their effectiveness will be eliminated. Although the powers of tax authorities are limited following such a provision, it better reflects the basic purposes of the MTC. The primary purpose of the MTC is to prevent obstacles to free trade that might be caused by the subjection to tax by more than one tax jurisdiction on the same income. The prevention of tax avoidance was only as a secondary purpose of the MTC. Other obstacles for free trade can arise following the current formation of the PPT rule. The lack of legal certainty, the fear of denial of treaty benefits without conducting an artificial shift of income, and the extra burden on the taxpayer's shoulders might all together prevent from legitimate economic arrangements of taking place. Hence, those modifications to the PPT rule will contribute to the achievement of both purposes of the MTC, and will not cause major conflict with EU law or with the GAAR provided by the ATAD.

4.4. Conclusion

After Chapter 2 and 3 provided with an overview of the legal framework and analysis of the elements and effectiveness of the GAAR provided by the ATAD and the PPT rule, this chapter consists of a comparison between the rules. This comparison was combined with several elements. The first part provided with an overview of the CJEU case law regarding the compatibility of tax treaty provisions with EU law, and an evaluation of the compatibility of the PPT rule with EU law. This evaluation detected few elements provided by the PPT rule that might prevent it of being in line with EU law. The lack of artificial requirement, the shift of the burden of proof regarding the objective element, and the entire denial of benefits are all elements of the PPT rule that may be considered as non-proportionate for the purpose of EU law. Moreover, the 'reasonless' standard of proof might not qualify with the EU requirement of legal certainty.

The second part started with an evaluation of the conflicts which are found between the GAAR provided by the ATAD and the PPT rule. This evaluation found substantial differences between the rules. The most significant deviation is the absence of artificial requirement in the PPT rule, meaning that unlike the GAAR provided by the ATAD, the PPT rule does not link between economic substance and the occurrence of abuse. Other meaningful deviations were found between the sanctions imposed by the rules, the standard of proof, and the function of the objective element. Further, I investigated the coordination issues that may arise in case of parallel implementation of the GAAR provided by the ATAD and the PPT rule by a MS. I found that the outcome of application of each rule on similar situations will be different in numerous cases, which reflects the different concept of tax avoidance on which each rule is based. This different treatment may be considered as a restriction on EU fundamental freedoms, mainly in cases

which involves treaties between MSs. In those cases, the uncertainty regarding the concept of tax avoidance which will be applied on the economic operation decreases the legal certainty provided by both GAARs, hence lowering their effectiveness. The accumulated result of the coordination issues between the GAAR provided by the ATAD and the PPT rule, and the fear that the PPT rule contradicts EU law, might deprive MSs from adopting the PPT rule. Such an outcome could prevent the PPT rule from accomplishing its aim of effectively confronting treaty abuse.

Therefore, the last part of this chapter consist of a suggestion for modifications to the PPT rule that would eliminate the coordination issues between the GAAR provided by the ATAD and the PPT rule, and reduce the risk of incompatibility of the PPT rule with EU law. First, an artificial requirement must be included in the PPT rule. Second, a clarification that the burden of proof of the objective element is on the tax authority. Third, the application of a stricter standard of proof than 'reasonableness'. Such modifications would reduce the coordination issues between the GAAR provided by the ATAD and the PPT rule since the outcome of application of both rules would be similar in most cases. Moreover, the risk that the PPT rule would not be in line with EU law in terms of proportionality and legal certainty would be eliminated. In addition, the overall effectiveness of the PPT rule will arise, while its ability to confront treaty abuse would not be reduced materially, taking into account the existence of completing LOB provisions.

5. Conclusions

The purpose of this conclusion is to answer the research and sub-research questions provided in part 1.2. Those questions reflect the structure of this thesis. The purpose of Chapters 2 and 3 was to answer the first research question: To what extent are the GAARs under consideration effective? In order to answer it, those chapters began with an overview of the tax avoidance concept on which each GAAR is based. After establishing the roots of each GAAR, the purposes of each legal source that formulated the GAARs and the role of the GAARs in those legal sources were examined. Furthermore, the different characteristics of each GAAR were examined: their scope, formation and elements. Finally, the first research question was answered through an investigation of the effectiveness of each GAAR, taking into account the degree of legal certainty it provides, and its ability to confront abusive behavior that otherwise resulted in revenue loss without hindering free trade.

Chapter 4 dealt with the second research question on the interaction between the GAARs: Does the interaction between the GAARs have negative affect on their effectiveness? In order to answer this question, the chapter began by considering the compatibility of the PPT rule with EU law. Furthermore, the differences between the GAARs were indicated. After recognizing the substantial differences between the GAARs, an evaluation of the possible coordination issues that may arise in case of parallel application of both GAARs was conducted. Those coordination were issues found to have a negative impact on the effectiveness of both GAARs. Hence, in the last part of this research I suggested modifications to the PPT rule, intended to reduce the negative impact of the coordination issues and eliminate the incompatibility of the PPT rule with EU law.

The GAAR provided by the ATAD is based on the concept of tax avoidance which was developed by the CJEU in its case law on tax avoidance. This case law dealt with situations in which a certain national tax measure of a MS was found to be restrictive regarding one of the EU fundamental freedoms. The suspect MSs claimed, among others, that the need to prevent tax avoidance is part of the CJEU 'rule of reason' and can justify a breach of EU freedoms. The CJEU shaped this concept of tax avoidance through a case-by-case method. In the landmark case of Cadbury Schweppes, the CJEU applied its concept of tax avoidance in the field of direct taxation. In order for the CJEU to accept a justification on the basis of the need to confront tax avoidance, three requirements should be accomplished: subjective test, objective test, and artificial requirement. This approach of the CJEU was ratified through several recommendations and communications of the EU Commission.

The GAAR provided by the ATAD has taken a form similar to the concept of tax avoidance in Cadbury Schweppes. It also includes a subjective test (*"one of the main purposes of obtaining a tax advantage"*),

an objective test (*"that defeats the object or purpose of the applicable tax law"*), and an artificial requirement (*"non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality"*). Two elements of the GAAR provided by the ATAD were found as problematic in terms of legal certainty. First, it is not clear whether or not the GAAR provided by the ATAD cover withholding taxes. Second, if the GAAR's sanction applies, the tax liability should be calculated in accordance with the national law of the relevant MS, which impedes uncertainty on taxpayers. However, the GAAR provided by the ATAD is based on a coherent legal basis which provides clear answers regarding the vast majority of the elements found in the GAAR. In addition, the GAAR provided by the ATAD is probably in line with the EU principle of legal certainty provided by the SIAT and Itelcar cases. Moreover, the GAAR provided by the ATAD has found to be sufficient in its ability to confront abusive practices without hindering free trade. It is true that the artificial requirement prevents tax authorities from confronting some of the abusive behaviors which has a certain degree of economic substance. However, it is a mandatory requirement that balances between the discretion given to tax authorities and taxpayers' rights. In conclusion, the GAAR provided by the ATAD has proven to be effective following the parameters set forth in this research.

The PPT rule was recommended as a new Article of the broadly used MTC. The MTC was first published in 1963, and together with its Commentary is considered as an effective tool of international law. The initial and primary purpose of the MTC was to eliminate double taxation through bilateral agreements between countries. The purpose of confronting treaty abuse was formally added to the MTC Commentary only in 2003, and did not succeed in effectively preventing the phenomenon of treaty abuse. Treaty abuse was only one of the abusive practices that are conducted by MNEs and causing serious revenues loss, mainly for developed countries. The OECD decided to conduct a reform in the field of international tax law in order to confront the BEPS phenomenon through its BEPS Project's final reports. Action 6 of the BEPS Project recommends dealing with the issue of treaty abuse by through the inclusion of LOB provisions and a PPT rule in the MTC Articles.

The recommended PPT rule has taken the form of a GAAR. It consists of a subjective element (*"obtaining that benefit was one of the principal purposes of any arrangement resulted directly or indirectly in that benefit"*) and an objective element (*"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"*). Unlike the GAAR provided by the ATAD, the PPT rule is lack of artificial requirement, meaning that this provision does not require a connection between economic substance and the occurrence of treaty abuse. Moreover, the elements of the PPT rule have been found to be biased in favor of tax authorities at the expense of taxpayer's rights. This conclusion follows the lack of artificial

requirement, a light standard of proof, and the shift of burden of proof to the taxpayer for purposes of the objective element.

There are two major issues which erode the legal certainty provided by the PPT rule. First, it is not clear whether the MTC provisions which merely allocate powers of taxation between contracting states are considered as providing 'benefits' for PPT rule purposes. Second, the standard of proof ('reasonableness') is not common alongside tax anti-avoidance measures and seems to be to 'soft' in relation to such measures. Hence, the degree of legal certainty provided by the PPT rule was found to be relatively low. The outcome of the lack of artificial requirement, the light standard of proof, and the shift in burden of proof regarding the objective element, is that the PPT rule can probably confront the vast majority of treaty abuse situations. However, in doing so, the PPT rule will also confront arrangements which have legitimate business purposes, and hence its adoption might hinder free trade. In conclusion, following the parameters set forth in this research for evaluating the effectiveness of GAARs, the PPT rule is not considered to be an effective rule.

A comparison between the GAAR provided by the ATAD and the PPT rule had found substantial differences between the rules. The most significant difference, as mentioned above, is the lack of artificial requirement in the PPT rule. Other meaningful differences were found regarding the sanctions provided by the GAARs, the standard of proof, the burden of proof, and the function of the objective element. The outcome of these differences is that in many cases in which the GAAR provided by the ATAD will probably not apply, the PPT rule can certainly apply. Moreover, there is a concrete possibility that the PPT rule is not in line with EU law in terms of legal certainty and proportionality.

Those meaningful differences impose coordination issues between the rules in case a MS would adopt both the PPT rule in its tax treaties and the GAAR provided by the ATAD as its domestic GAAR. The most obvious risk is found in pure EU situations. Because the powers of the competent tax authority under the PPT rule are much greater than its powers under the GAAR provided by the ATAD, it is possible that MSs will prefer to apply the PPT rule. In the event that a taxpayer is eligible for EU fundamental freedoms, he might claim that application of the PPT rule in his case is a discrimination that constitutes a breach of his EU freedoms. The relevant MS would have difficulties in justifying application of the PPT rule by the need to confront tax avoidance due to the possible incompatibility of the PPT rule with EU law and because of the use of a concept of tax avoidance that differs from the EU concept of tax avoidance. The uncertainty regarding the applicable GAAR in purely European situations further damages the legal certainty provided by both the PPT rule and the GAAR provided by the ATAD and has a negative impact on their effectiveness.

In order to reduce the coordination issues and to eliminate the possibility that the PPT rule would not be in line with EU law, I suggested three modifications to the PPT rule. First, an artificial requirement that would form a connection between economic substance and treaty abuse has to be included. Second, the objective element should function as a requirement for the competent tax authority when it considers the application of the PPT rule. Third, the standard of proof must be stricter in order to prevent arbitrary decisions by the competent tax authority. Such modifications would reduce the tension between the PPT rule and the GAAR provided by the ATAD since most of the cases would result in the same outcome irrespective of which GAAR applies. Therefore, the coordination issue would lose much of its importance. Moreover, the possibility that the PPT rule would not be in line with EU law would be eliminated, since it will qualify the proportionality and legal certainty requirements. In addition, the effectiveness of the PPT rule would increase, first, by strengthening legal certainty through the standard of proof and second, if the PPT rule will target only artificial arrangements, the hindrance to free trade will be reduced considerably. In conclusion, a modification of the PPT rule in accordance with the recommendation provided by this research would considerably reduce the negative effect that the interaction between the GAAR provided by the ATAD and the PPT rule has on the effectiveness of these rules.

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