The Principal Purpose Test of the OECD Multilateral Agreement and the General Anti-Avoidance Rule of the Anti-Avoidance Directive.

Effectiveness of the Principal Purpose Test and comparison with the General Anti-Avoidance Rule of the European Union.

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List of Abbreviations

ATAD – Anti-Avoidance Directive

BEPS – Base Erosion and Profit Shifting

CCCTB – Common Consolidated Corporate Tax Base

CEN - Capital Export Neutrality

EU - European Union

EUCJ – European Union Court of Justice

GAAR - General Anti-Avoidance Rule

IEN – Import Capital Neutrality

MLI – Multilateral Instrument or Agreement

OECD - Organization for the Economic Cooperation and Development

PPT – Principle Purpose Test

PSD – Parent Subsidiary Directive

SAAR – Specific Anti Avoidance Rule

VAT – Value Added Tax

Preface

Treaty abuse is one of the most harmful practices in the field of international taxation identified by the OECD BEPS project. Measures such as the incorporation of general anti-abuse rules in treaties through the Multilateral Agreement were considered necessary to tackle various forms of treaty abuse. One of those measures is the PPT rule contained in that instrument. The purpose of this work is to address that rule, analyze its scope, nature, and components and determined if it is an effective way to combat the abovementioned problem. With that in mind, a comparison with a similar rule put in place at the level of the European Union is used as the benchmark. After analyzing both regimes the findings were that the PPT rule has certain characteristics that could reduce its efficiency in combating treaty abuse. PPT rule could affect legal certainty and their wording flaws could cause an uneven application around different jurisdictions. That, in turn, would result in similar situations treated in a different manner. Consequently, a more sophisticated tax planning among taxpayers that commonly use those practices, and at the same time, it could affect bona fide transactions. This is the result of patchwork solutions that do not address one of the roots of the problem that is the system in which taxation rights are distributed between jurisdictions.

Contents

List of Abbreviations 2
Preface 3
Section I - Introduction 6
1.1 Background 6
1.2 Motivation of the research 7
1.3 Benchmark 8
1.4 Research method and materials 8
1.5 Outline 9
Section II – Normative Framework 11
2.1 Introduction Overview of the double taxation, tax treaties and treaty shopping issues 11
2.2 Concepts of tax avoidance, tax planning and abuse of law 11
2.3 Notion of GAARs 18
2.4 Concluding remarks 19
Section III - The PPT rule in the OECD Model and the MLI 21
3.1 Background 21
3.2 Analysis of the wording of the OECD PPT 23
3.2.1 Reasonable test and principal purpose test 25
3.2.2 Subjective element 26
3.2.3 Denial of benefits 28
3.2.4 Objective element 30
3.2.5 OECD Commentaries Examples 32
3.3 Conclusions 33
Section IV – GAAR at the EU Level 35
4.1 Introduction 35
4.2 Development of the concept of Abuse of Law in the EU Case Law 35
4.2.1 Landmark cases 36
4.2.2 The influence of EUCJ case law in the EU GAAR framework 39
4.3 Background of the ATAD-GAAR 40
4.4 Analysis of the wording of the ATAD provision 41
4.4.1 Subjective element 43
4.4.2 Objective element 44
4.4.3 Artificial arrangements 45
4.4.4 Consequence of the application of the GAAR 46
4.5 Conclusions 47

Section V – Analysis and evaluation 48
5.1 Introduction 48
5.2 Comparison of the findings of each rule 48
5.3 Effectiveness of the MLI/OECD Model GAAR 50
5.4 Conclusions 52
Section VI – Final Conclusions 54
Bibliography 55

Section I - Introduction

1.1 Background

Taxes play a critical role in the social order. They are not only a means of revenue raising for governments and public bodies, but more importantly an instrument through which political systems put into practice the concept of economic and distributive justice. How much should be paid by whom? What should be deductible? What kind of inequalities are justified? What kind of taxes are paid by different members of society? These issues are central to a fundamental moral discussion which is carried out by every community[1].

Multinational Enterprises are not outside of this debate. Quite the contrary, they are at the very center of it. Aggressive tax planning, the use of loopholes and exceptions, the shifting of profit to low or non-corporate income tax are among the practices which have allowed them to reduce the tax burden. This has caused a storm of criticism and indignation within the court of public opinion. This reaction has prompted governments to tackle the negative consequences of aggressive tax planning.

The need to prevent base erosion and profit shifting was expressed for the first time in June 2012, when G20 countries articulated the intention to tackle the issue of profit shifting to jurisdictions with no or low corporate taxation, the use of hybrid mismatches and other abusive practices[2]. Countries and supranational bodies have been working together to address this issue in an ongoing project Base Erosion and Profit Shifting (BEPS) led by the Organization for Economic Co-operation and Development (OECD).

BEPS Action Plan dated October 5, 2015 introduced 15 actions essentially aimed at closing the gaps and loopholes in international taxation which have allowed companies to reduce their payment of tax. The three key pillars of this actions are: introducing coherence in the domestic

[1] Murphy & Nagel, 2002, 'The Myth of Ownership: Taxes and Justice' Oxford University Press, p. 3

[2] Danicz 2017, 'BEPS Action 6: The Introduction of a Saving Clause in the OECD MC' Limiting Base Erosion, Series of International Tax Law, Michael Lang (Ed) Linde Verlag, p. 4.

rules that affect cross-border activities; reinforcing substance requirements in the existing international standards; and improving transparency as well as certainty[3] .

BEPS Action 6 particularly addresses treaty shopping, which is one of the most important sources of loss of revenue by countries. It contains specific measures to counteract these practices. The object of this thesis is to focus on the General Anti-Avoidance Rule (GAAR) and the Principle Purpose Test (PPT), which is included in Article 29 of the OECD Model, and Article 7 of the Multilateral Agreement (MLI) signed on June 7th, 2017 by more than 70 countries and jurisdictions, and also an examination of the General Anti-Avoidance Rules and their application in the European Union.

1.2 Motivation of the research

Many scholars agree that, the insertion of the PPT rule in the MLI is one of the most controversial issues of the BEPS project and one that is going to have a great many consequences to multinational companies and their tax advisers[4]. Probably, it is one of the rules established in the MLI that is going to be revised and interpreted to the greatest degree by different tax authorities and courts around the globe. Each regulator and judicial body is going to interpret the norm with different approaches, depending upon their internal system of interpretation of international law.

This rule represents a change in the paradigm in terms of the strategies used to tackle tax avoidance by countries. The aim of this rule is to close gaps with a general approach giving tax authorities extensive powers to act in relation to tax planning that is considered abusive. This change gives rise to questions regarding certain principles applied in liberal democratic regimens, particularly the principle of legal certainty. In consequence, it is an important issue which will bring about a great deal of investigation in the theoretical field with a number of possible conclusions.

This study aims to analyze one of the measures developed to tackle treaty shopping and the implementation of it at the level of the Multilateral Agreement. The primary research question

[3] OECD 2017-I, 'Harmful Tax Practices – 2017 Progress Report on Preferential regimes: Inclusive Framework on BEPS: Action 5'. OECD Publishing. http://dx.doi.org/10.1787/9789264283954-en, p. 3

[4] Danon, 2018, 'Treaty Abuse in the Post-BEPS World: Analysis of the Policy Shift and Impact of the Principal Purpose Test for MNE Groups' Bulletin for International Taxation, IBFD, p. 1.

to be addressed is to what extent is the PPT rule contained in Article 29 of the OECD Model, and Article 7 of the Multilateral Agreement (MLI) effective in order to minimize the use of aggressive tax planning; and how the principle of legal certainty could be affected by it. Additionally, the reason that determined the inclusion of this rule within the framework of the MLI will be analyzed.

1.3 Benchmark

In this study, a comparison is made between the PPT rule introduced in the MLI, and other similar anti-avoidance rules already in place at the level of the European Union. Therefore, not only EU normative issues will be addressed, but also the EU Commission documents and the EU Supreme Court ruling will be examined.

1.4 Research method and materials

'It is indispensable to establish at least two things, first that law is a science; secondly that all available materials of that science are contained in the printed books'. Langdell[5]

When analyzing legal research methodology Kroeze[6] expressed the idea that there is a continuum in the acquisition of knowledge. On one side there is an exclusive empirical observation of facts, and on the other there is a purely rational deduction of knowledge. Determining a position along this continuum in terms of the science of law is also a part of Kroeze's thesis topic. In order to address the topic, the concept of empericism is addressed, this concept dictates that by observing the object, scientists can deduct the rules that govern it, and relying upon these formulated rules can predict future events. On the contrary, rationalism assumes that the consideration of a problem with the aim of finding an answer is rational and logical.

Legal researchers do not use different materials available (law, case law, studies of other authors) in an empiricist manner, that is to say, to predict the future because the law is inherently unpredictable. Instead, they use those materials as starting points for the interpretation of what

[5] Kroeze, 2013, 'Legal Research Methodology and the Dream of Interdisciplinary', 16 Potchefstroom Elec. L.J. 35, p. 44.

[6] Ibidem, p. 42.

the law is and might be. The author concludes that law is a human discipline and therefore it is governed by canons of precision, the rigour of argumentation, clarity in presentation of evidence, and openness to criticism[7].

Using such a concept of the discipline of the law as described above, the author offers three approaches. The empirical discipline approach where case law, legislation and so on is treated as data to be studied and thus legal research is a description of legal rules and doctrines. The second approach views the law as a hermeneutic or argumentative discipline focusing principally on the arguments that are acceptable within the Law. The last conception emphasises legal research as a means of constructing a normative framework for the Law to enable normative choices.

The second approach is to be used for this thesis. Thus, research will not only be considered in terms of the rule and the interpretation of it by scholars, but will also consider the history, comparative perspective and socio-political circumstances of the object of study.

Materials to be consulted to produce this investigation consist of sources of international law, soft law, papers related to the production of those documents by international organizations or participant States, case law and academic literature contained in books, tax journals and articles. OECD documents, in particular, the text of the Articles and the Commentaries to those articles and Case Law of the European Court of Justice will be analyzed. The analysis of the research question will be based on both the literature and the normative framework and the author will put forward his own view in the Conclusion.

1.5 Outline

Treaty abuse schemes are possible, among other reasons, because of the way the system is designed to avoid double taxation, especially because it gives residents' states major preference over taxation in the international field. This creates some inconsistencies in the system that facilitates tax schemes. In Section I – Normative Framework – before dealing with the research questions there is an introduction to the reference systems because their bases are substantial source of the treaty abuse problem.

Therefore, in order to address this complex issue some basic concepts will be summarized as it is these that have given rise to the problem that the PPT rule attempts to deal with. Hence, in

[7] Ibidem, p. 45.

Section II – Normative Framework – the author presents the reasons why double taxation may arise and how countries have decided to address this issue. Furthermore, the consequences that are produced by the measures to avoid double taxation, and the reasons why the developed system may give rise to abusive tax planning will be analyzed. Finally, the main measures that have been developed to avert the adverse consequences of tax planning, in particular, the General Anti-Avoidance Rule known as Principle Purpose Test, are addressed.

In the second part of this thesis – Sections III and VI – the author researches the specific question of the way in which the General Anti-Avoidance Rules should be revised. Analysis of the specific provision is conducted. Comparison with the text of the OECD PPT and the EU General Anti-Avoidance Rules, and especially, the application of those measures by the European Court of Justice is examined. Finally, in Section V and VI present the evaluation between the two different systems and the summary of the findings including the answer to the research question.

Section II – Normative Framework

2.1 Introduction Overview of the double taxation, tax treaties and treaty shopping issues

Before commencing a detailed analysis of the research question, it is important to highlight the most essential characteristics of the framework with which we are dealing in the context of abuse of law in the international tax law field. For that reason the following issues are presented: a) the reason that countries celebrate double tax conventions; b) why cross-border economic transactions make it necessary for enterprises to develop a certain degree of tax planning; c) why double tax conventions and tax planning may facilitate tax avoidance; and finally d) countermeasures to tackle that problem that have serious negative consequences to countries.

2.2 Concepts of tax avoidance, tax planning and abuse of law

Domestic tax systems take into consideration personal connection factors or criteria to tax a person. Those factors include nationality, residence and the source of income.

If a person has close personal connections with two or more states, that person could be subject to multiple tax liability. This is because there is no limit imposed by international law *per se* by virtue of the principle of sovereignty[8]. That absence of rules allows that each state determines unilaterally the basis on which connecting criteria its taxing powers are claimed. Double taxation not only arises because of different factors, but because each of these factors is regulated differently in each tax jurisdiction.

The concept of international juridical double taxation consists of five elements. The imposition of comparable taxes, by two or more states, regarding the same taxpayer - the same subject - and the same subject matter and in relation to identical periods. Economic double taxation arises when the same economic transaction, item or income is taxed in two or more states during the same period, but in the hands of different taxpayers[9].

Taxation of residents (or nationals) gives rise to full tax liability over the worldwide income generated by the taxpayer. This principle takes into consideration the subject's ability to pay. On the contrary, the source rule gives states the power to tax only over the economic activities

[8] Lang 2013, 'Introduction to the Law of Double Taxation Conventions', IBFD, 2nd edition, Linde Verlag, p. 27, 28.

[9] Kemmeren 2001, 'Principle of Origin in Tax Conventions', Pijnenburg vormgevers.uitgevers, p. 12.

within the limits of its territory. This principle is based on the demonstration of wealth in certain territories. Various principles are relevant to the relationship between the taxpayer and the source and residence state. Those are the standard principles that govern the levy of taxes such as state/taxpayer relationship, fairness and simplicity[10].

Neutrality is one of the principles of international taxation. Taxation of residents corresponds to the principle of capital export neutrality and taxation at source corresponds to the principle of capital import neutrality. CEN presupposes that all the nationals or residents of one country should have the same level of taxation, either investing at home or abroad, thereby preventing tax considerations to influence business decision. CIN implies that foreign investors bear the same overall tax as domestic investors[11].

The principle of economic efficiency takes into consideration an economic perspective suggesting that the tax must not influence a functioning market. Therefore, the allocation of resources is decided bearing in mind where it is most productive to obtain the major business advantage and not influenced by tax grounds[12].

States could take measures to eliminate or limit the consequences of double taxation at two levels: through unilateral measures at a domestic level or entering bilateral international tax conventions. In both cases, those measures are taken to prevent companies from having a double cost simply for investing and producing abroad. The burden of double costs could restrict the possibilities of those companies to invest or produce in a cross-border projects. Therefore, removing the obstacles that produce double taxation is essential for the development of economic relations between countries by promoting the exchange of goods, services, movement of capital, technology and persons[13].

Tax treaties are celebrated with the purpose of allocating tax powers through the so-called distributive rules. Each of these rules tells the interpreter the extent to which a state has the right to tax under a specific treaty. Correction of double taxation could be made through conferring the right to tax to one state only, or by dividing that right between the two states and determining the portion of the tax that corresponds to each. It should be noted that the system of distribution

[10] Harris & Oliver 2010, 'International Commercial Tax', Cambridge University Press, p. 88.

[11] Ibidem, p. 23.

[12] Ibidem, p. 89.

[13] OECD 2017-II, 'Model Tax Convention on Income and on Capital' Condensed Version 2017, OECD Publishing, http://dx.doi.org/10.1787/mtc_cond-2017-en, p. 9.

of the right to tax may also give the opportunity for international companies to engage in (abusive) tax planning.

The system in place to avoid double taxation is far from being complete. Therefore, it gives multinational companies opportunities to take advantage of it which puts them in a better position than pure domestic business. This is because there is little coordination between countries in the field of international taxation. There is no International Court that could make decisions in disputed cases or could give a unifying interpretation of the system. Even worse, the tax competition between countries to attract and retain investments sometimes promotes the inadequate use of instruments. Double tax conventions are put in place to facilitate international flow of capital, goods and services, but in some cases are used with the sole purpose of obtaining tax advantages. In these cases - in which artificiality is used by companies - the purpose of the double tax treaties is undermined.

Having said this, it is important to clarify that not all tax planning or schemes are abusive. To a certain extent, some degree of planning is required based on the fact that companies deal with an incomplete set of rules in the field of international taxation.

Tax planning has been defined as 'the art of arranging cross-border transactions with the knowledge of international tax principles to achieve a tax effective and lawful routing of business activities and capital flows[14]'. Taxes should not be the driving force of a company for investing abroad. However, a certain degree of coordination is necessary once the decision has been taken. Factors such as viability of the investment, availability of resources, market access and potential, political and economic stability, labour costs, among others, must be taken into account.

This planning will have the objective of reducing the consequences of lack of harmonization in the interaction of various tax systems. The aim of international tax planning is to minimize the tax burden of an international group taking into consideration its right to establish a business in the most efficient tax way[15]. Tax structure should be adopted in accordance with the business

[14] Rohatgi 2001, 'Basic International Taxation', Volume II: Practice, 2nd edition, BNA International, p. 1.

[15] Endlers & Spengel 2015, 'International Company Taxation and Tax Planning' Kluwer Law International, p. 391.

structure. Tax authorities will attack artificial structures, whose main reason is exclusively that of a tax nature and will not be efficient in the medium term[16].

Following the reasoning of Rohatgi, three main stages in tax planning can be identified[17]. Taxation at the source of the investment can be reduced using incentives, deductions, losses, the use of techniques to reduce withholding taxes that may arise, and the selection of an adequate vehicle to carry out the investment.

The second level of tax planning presupposes the use of an intermediary jurisdiction, which may introduce the concept of treaty shopping in tax planning. Treaty shopping consists of: a) using tax treaties to reduce taxes in the host country, b) selection of offshore financial centers to minimize or avoid the corporate and withholding taxes, c) arbitrage through a change in the nature or character of the payment made to the home country, d) use of tax concessions, and e) retention of funds offshore for reinvestment abroad to achieve deferral on remittances made to the home country.

The last step consists of the minimization of the tax imposed by the investor's country by using the appropriate global corporate structures that avoid, reduce or defer the tax liability or the use of foreign tax credits and exemptions to reduce domestic tax liabilities. This last step has the objective of retaining as much as possible the tax savings obtained abroad which might be lost by generating a higher imposition at resident level.

Having introduced the concept of tax planning we should study it with more detail to determine in which cases this could become abusive or contrary to the purpose of the international tax treaties celebrated by countries. For that reason, the concept of abuse of law is addressed because it is considered to be the conceptual base upon which abuse in the context of tax treaties is defined.

The abuse of law (*frau legis*) refers to a civil law doctrine that states that the intention of the legislator prevails over the formal transaction when it distorts the economic reality that is

[16] Vega 2017, 'Limitation on Benefits Clauses in Double Taxation Conventions' Kluwer Law International, p. 15

[17] Rohatgi 2001, v.2, p. 2, 3.

behind it (substance over form)[18]. The apparent transaction - which may be entirely legal and valid - had no other purpose than to cover the real one. This construction is put in place with the sole intention of obtaining an unintended benefit. In the context of taxation abuse of law presupposes the existence of two rules: the avoided rule, which give rise to the tax liability; and the coverage rule which declares the taxable event exempted or not subject to tax[19].
In general, a Court could apply *frau legis* and disregard the formal transaction and replace it by the real one that is covered if three conditions are met[20]:

- Tax avoidance must be the only or the major reason for the transaction;
- The transaction must lack real purpose other than the avoidance of the tax;
- The tax consequences must violate the intention of the legislator.

The doctrine makes a distinction between abusive and *bona fide* transactions. Therefore, it does not deny the taxpayer the right to select the most convenient legal form to minimize taxation as long as it is not 'abnormal or unusual'[21].

As indicated by Öner in the context of EU law (but applicable for every tax system in general) the principle of prevention of abuse of law governs the understanding of tax avoidance. Tax avoidance is a form of abuse of law which implies the use of the legislation to minimize the tax burden by indirectly violating the norm itself. The taxpayer uses transactions that are artificial, unnatural or do not correspond with economic reality[22].

This conceptual framework is the foundation on which treaty anti-abuse rules are based when addressing the problem of abusive tax planning or tax arrangements. Treaty abuse has been defined as the granting of treaty benefits in inappropriate circumstances. Based on OECD Commentaries scholars have identified two types of treaty abuse: Type 1 - when the taxpayer

[18] Prebble & Prebble 2008, 'Comparing the General Anti-Avoidance Rule of Income Tax Law with the Civil Law Doctrine of Abuse of Law' Bulletin for International Taxation April 2008 IBFD, p. 153

[19] Vega 2017, p. 56

[20] Rohatgi 2001, v.2, p. 152.

[21] Ibidem, p, 153.

[22] Öner 2018, 'Is Tax Avoidance the Theory of Everything in Tax Law? A Terminological Analysis of EU Legislation and Case Law' EC Tax Review, 2018-2, Kluwer Law International BV, The Netherlands, p. 112.

circumvents limitations of the treaty itself, generally known as treaty shopping; Type 2 - cases in which the taxpayer circumvents domestic laws by using treaty provisions[23].

De Broe & Luts determined two elements in the first type which are: a) a taxpayer is subject to a domestic law that gives rise to a tax liability, and b) by (improperly) invoking a treaty provision the taxpayer avoids the mentioned tax liability to arise. In the second type the authors identified three elements: a) a taxpayer (improperly) places himself beyond a domestic provision that give rise to a tax liability or under one that reduces the tax burden; b) a domestic anti-avoidance rule is introduced to tackle the improper situation in which the taxpayer places himself; and c) the taxpayer invokes a treaty provision which has higher juridical ranking to avoid the application of the domestic anti-avoidance rule[24].

Treaty shopping involves strategies through which a person who is not a resident of a country that is part of a specific tax treaty tries to take advantage of the benefits of that treaty that is available only for residents of treaty countries[25].

Treaty shopping structures relate to the second level of tax planning when the income is routed to the state of residence. This is usually arranged through the incorporation of a company in a state that has concluded a double tax convention with the source state. The operation is facilitated by the restricted definition of enterprise given by the system. Entities are considered independent and with their own legal personality even though they are under the control of a higher business unit[26].

This kind of operation is the result of the single entity approach which is based on the OECD double convention system. One way of addressing this issue could be by the introduction of the formulary apportionment method. The basic idea of it is to divide the net income of an

[23] Palao 2015, 'OECD Base Erosion and Profit Shifting Action 6: The General Anti-Abuse Rule', Bulleting for International Taxation, IBFD, p. 602.

[24] De Broe & Luts 2015 'BEPS Action 6: Tax Treaty Abuse' Intertax, v. 43, Issue 2, Kluwer Law International B.V., The Netherlands, p. 125.

[25] D'Aula 2017, 'BEPS Action 6: The Introduction of a Saving Clause in the OECD MC' Limiting Base Erosion, Series of International Tax Law, Michael Lang (Ed) Linde Verlag. P. 103.

[26] Vega 2017, p. 23, 38, 39.

enterprise doing business in more than one jurisdiction by using a formula[27]. The profit would be distributed through jurisdictions taking into consideration each part of the enterprise and how it contributed to the generation of the income. This would permit the elimination of double taxation because each country may tax only the portion of income that has been assigned to it. The introduction of this system would not be without problems especially with regard to the determination of the formula and the division of profits.

Given that the system is in place it is important to analyze why treaty shopping supposes a threat to it. For that reason, it is necessary to see at the core of the negotiation process between countries to enter into a double tax treaty. Tax treaties are a reciprocal exchange of compromises in which basically one country reduces their taxes if the other one does too. When entering a double tax convention states take into consideration tax revenue losses, foreign direct investment expectation, and the benefit for their local investors[28], among others. The economic elements on which the negotiation was based may be substantially altered by treaty shopping because if an enterprise of a third country obtains benefits which were not considered when entering that agreement that could shrink the basis on which that particular tax treaty was drawn up[29].

Treaty shopping primarily affects source states but also resident states. It particularly impacts on the principles of reciprocity and the balanced revenue sacrifices, diminishes the bargaining powers of states in negotiations, reduces the incentive to sign treaties with third countries, and encourages intermediary transactions with no economic substance among other harmful effects[30].

Tax avoidance, unlike tax evasion, is not a criminal activity; it takes place when taxpayers use weaknesses and ambiguities of the law to reduce their tax burden. Although not unlawful the result is considered abusive and contrary to the intent of the law[31]. Usually, lack of business

[27] McLure 2002, 'Replacing Separate Entity Accounting and the Arm's Length Principle with Formulary Apportionment' Bulletin December 2002. International Bureau of Fiscal Documentation, p. 587.

[28] Broekhuijsen 2017, 'A multilateral tax treaty: designing an instrument to modernise international tax law' Leiden University Repository, p. 75.

[29] Vega 2017, p. 47.

[30] Rohatgi 2001, v.2, p. 165-168.

[31] Ibidem, v.2, p. 139.

purpose, a certain level of discretion and taking advantage of loopholes in the law are decisive characteristics of tax avoidance[32]'.

In treaty shopping, the transaction is not illegal *per se* but rather the objective of the transaction is created artificially. The main problem is related to the fact that it is necessary to prove that the transaction created by the taxpayer is artificial and not acceptable. Treaty shopping is proven externally, usually by the lack of plausible justification for the specific transaction selected by the taxpayer[33]. Anti-abuse rules are put in place to correct this kind of operation whose only purpose is to reduce taxation at different levels.

In response to this practice the BEPS Action Plan 6 has suggested countries should address treaty shopping by various approaches: a) stating clearly when entering in a tax treaty their intention of creating opportunities for non-taxation, b) adopting specific anti-abuse rules limitation on benefits (LOB) and c) the adoption of general anti-abuse rules based on the principal purpose of transactions or arrangements[34].

2.3 Notion of GAARs

Governments of the world have reacted to the use of tax avoidance techniques by introducing different types of anti-avoidance measures either legislative, judicial or administrative solutions[35].

Specific anti-avoidance rules cover certain types of tax abuse. They are also referred to as the 'sniper approach' because they detect already known uses of loopholes by taxpayers and close them. Generally, SAARs are the result of the application of the tax law by Courts in an inconsistent manner with the spirit of the law but in accordance with the terms of it provoking legislative corrections[36].

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[32] Endlers & Spengel 2015, p. 391.

[33] Vega 2017, p. 57.

[34] OECD 2015, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264241695-en p. 9.

[35] Ostwal & Vijayaraghavan 2010, 'Anti-Avoidance Measures' National Law School of India Review. Vol. 22(2) p. 63.

[36] Rohatgi 2001, v.2, p. 141.

General anti-avoidance rules apply a general test to counter tax planning that leads to unacceptable loss of tax revenue through improper methods that are against the purpose of the law. It is defined as a rule that attempts to protect the tax base by allowing tax authorities to disregard a tax erosion transaction[37]. In short, GAARs are instruments given to tax authorities to dismantle transactions whose aim is to obtain a tax benefit contrary to the principles of the norm.

2.4 Concluding remarks

In this Section a framework of the issues that are addressed in this thesis were presented. It was important to understand the system which is in place in the field of international taxation and how it is designed. Its characteristics in certain cases facilitate tax abuse by taxpayers. The fact that there is little coordination between countries and tax competition foster taxpayers' abusive practices.

More recently countries have begun to work together to tackle the abuse of law in the field of international taxation. For that reason, different types of measures have been designed, which include specific and general anti-avoidance measures. General anti-abuse rules are based on the civil concept of abuse of law which has been adapted for tax purposes. Each system – OECD and ATAD –has its own particularities and has evolved in a distinct manner.

This development, however, still presents difficulties in its application because of the nature on which they are based. Some authors consider that tax avoidance could be more effectively tackled by amending the system in which double tax conventions are based by moving from a resident principle-based taxation to an origin principle-based taxation[38]. Nevertheless, it has not

[37] Rohatgi 2001, v.2, p. 142.

[38] Kemmeren 2001, p. 533-536. The author points out that 'the principle of residence on which the establishment of the subjects eligible for treaty benefits has been the basis for the (main) cause of the deficiencies. In principle, only a resident has access to tax conventions and its benefits. Therefore, under the current system, it is of principal interest, for a person wishing to benefit from a state's treaty (network), to be a resident. Consequently, residence plays a key role in international tax avoidance, including treaty abuse, since the place of residence can be chosen or transferred in order to claim the desired treaty benefits without necessarily affecting the income-producing activity. […] The deficiencies addressed require that the flaws of the

been the approach taken by the OECD and EU when dealing with the problem of abuse of law. We now must deal with those consequences and the problems that might arise from the application of the anti-avoidance rules. In particular, the focus of this thesis is oriented towards the consequence of the General Anti-Avoidance rules at the level of the OECD and EU ATAD which are presented in the following chapters.

current double tax convention model be eliminated. The current models need to be amended. The principle of origins offers the best opportunities for a justified and tax neutral allocation of tax jurisdiction on income and capital…'.

Section III - The PPT rule in the OECD Model and the MLI

3.1 Background

The introduction of the PPT rule in the OECD Model and the MLI is the result of the BEPS Project Action 6 which has the aim of developing 'model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances'[39].

The PPT rule is introduced by the OECD as SAARs alone cannot deal with creative tax planning developed to reduce or eliminate tax liabilities. This type of anti-avoidance rules does not define the characteristics of the abusive transaction but rather focuses on the principal objective of the transaction allowing tax authorities to disregard the tax purposes of any arrangement and deny tax benefits in case the main purpose of it is to obtain those benefits[40].

The MLI has been introduced by the OECD as a form to include very important measures in a single coordinated text that are considered necessary to be adopted in order to tackle base erosion and profit shifting[41]. The use of a multilateral instrument, which is not very common in the international tax law field, was chosen for a variety of reasons, including the number of bilateral instruments that would have to be amended in order to introduce these rules in the global treaty network. Another reason was the amount of time that would have been taken for the negotiation of each bilateral treaty by different countries. Finally, the difficulties to assure the commitment of contracting states, especially those that are not OECD members, in order to adopt these measures in their network of treaties[42][43].

[39] OECD 2015, p. 13.

[40] Kolosov 2017 'Guidance on the Application of the Principal Purpose Test in Tax Treaties' Bulletin for International Taxation, 2017 (Volume 71) N. 34, p. 2.

[41] Gomes 2018, 'International Taxation and the Challenges for Multilateralism in the Context of the OECD Multilateral Instrument' Bulletin for International Taxation, 2018 (Volume 72), No. 2, p. 6.

[42] Ibidem, p. 6.

[43] OECD 2017-III, 'Explanatory Statement to Multilateral Convention to Implement Tax Treaty related measures to prevent Base Erosion and Profit Shifting', paragraphs 4-8.

Another relevant aspect that must be considered in the inclusion of the PPT rule in the MLI is the conflict that could be generated by the application of domestic GAARs to international treaties; and the possible failure of states to fulfil obligations imposed by international tax treaties. Provision established in treaties must be applied in accordance with the international law principle *pacta sunt servanda* as stated in Articles 26 and 27 of the Vienna Convention: 'every treaty in force is binding upon the parties and must be performed in good faith'. Contracting states commit themselves not to impose a tax in situations in which tax treaties limit their taxing rights[44]. The application of a domestic anti-avoidance to override a treaty provision would imply a breach of International Law by one of the Contracting States that could be invoked by the other Contracting State[45].

It was not until 2003 that the OECD Commentaries positioned clearly toward the compatibility between domestic anti-abuse measures and treaty provisions[46]: 'Anti-avoidance rules are part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability, they are not addressed in tax treaties and therefore not affected by them. Thus, generally, there will be no conflict between such rules and the provisions of tax conventions'[47]. That position was adopted by most of the OECD Members except for Luxembourg, the Netherlands and Switzerland which observed the interpretation adopted by the OECD[48].

Before the 2003 position, the OECD had the view that domestic anti-avoidance rules should be included or confirmed by treaty provisions. Therefore, there are reasons to suggest that this new interpretation could only be applied for treaties celebrated after 2003 and not to those entered in force before, and it is probable that tax authorities and the court of different jurisdiction may adopt different positions in that regard[49].

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[44] De Broe 2008, 'International Tax Planning and Prevention of Abuse', Doctoral Series n.14, IBFD, p. 306.

[45] Tomazela 2016, 'The United Kingdom's Diverted Profits Tax and Tax Treaties: An Evaluation', Bulletin for International Taxation, v. 70, n. 7, p. 404.

[46] De Broe 2008, p. 588-589.

[47] OECD 2014, 'Model Tax Convention on Income and on Capital: Commentary on Article 1', para. 9.2 (26 July 2014), Models IBFD.

[48] Tomazela 2016, p. 402.

[49] Ibidem, p. 402-403.

Particularly in regard of GAARs, De Broe & Luts point out that the OECD has admitted that in treaty shopping strategies the abused rules are related to tax treaties and therefore it is unlikely that those situations could be addressed only by domestic anti-avoidance rules[50]. In type 2 of abuse of treaties, as mentioned in Section 2.2 of the previous chapter, the application of a domestic anti-avoidance rule is neutralized by the taxpayer invoking a treaty provision. Therefore, it is considered necessary to tackle type 2 of abuse of treaty in terms of the coordination between domestic anti-avoidance rules and treaty provision[51]. Consequently, these are reasons why it has been determined by the OECD that there is the necessity of a coordinated and simultaneous process of amendment of the worldwide treaty network.

It is important to note that the PPT rule is presented as one of the central commitments of the MLI. It is indicated as one of the minimum standards of the agreement is that signatory states were not allowed to make reservations on it, unless that minimum standard was already achieved[52].

The minimum standard could be satisfied by the introduction of a detailed LOB only if that jurisdiction had rules protecting abuse of treaties either in domestic law, or in the bilateral treaties themselves. Almost all the 70 states opted for the PPT rule, and a few opted for this rule in addition to the simplified LOB rules[53].

3.2 Analysis of the wording of the OECD PPT

The rule is worded as follows:

> 'Notwithstanding the other provisions of this Convention, a benefit under the Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, 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, unless it is established that granting that benefit in these circumstances would be in

[50] De Broe & Luts 2015, p. 127.

[51] De Broe & Luts 2015, p. 126-127.

[52] Broekhuijsen 2017, p. 85.

[53] Herzfeld 2018, 'US Perspectives on the Multilateral Instrument', Intertax, v. 46, Issue 1, Kluwer Law International B.V., The Netherlands, p. 82.

accordance with the object and purpose of the relevant provisions of this Convention'.

'Notwithstanding the other provisions of this Convention' is introduced by the rule to establish that the application of this PPT rule (GAAR) is above what is expressed in all other provisions of the Convention, especially considering that the same Model Convention introduces a specific provision to tackle tax avoidance (SAAR)[54].

If there is any doubt about this interpretation regarding the application of the PPT rule over the LOB provisions, the OCED Commentary clarifies it by expressly stating 'the fact that a person is entitled to benefits under paragraph 1 to 7 does not mean that these benefits cannot be denied under paragraph 9[55] '… these rules do not imply that a transaction or arrangement entered into by such a resident cannot constitute an improper use of treaty provision'[56].

Even at this point of the provision, some authors have already expressed their concern about its wording pointing out the contradiction that supposes the suppression of the benefits by the GAAR if the arrangement is within the legal limits of the SAAR. The rule and the interpretation stated in the OECD Commentary of the PPT rules are not in accordance with the maxim *lex specialis derogat legi generali*. This unwritten principle states that when there is a specific piece of legislation for a situation, its application prevails over a general law. The PPT is the general rule and the LOB the specific rule once the arrangement passes the LOB test, it should be out of the scope of the PPT rule[57].

The application of the PPT rule over the LOB – when an arrangement has been classified as legal – could clearly collide with the principle of legal certainty and the bona fide application of tax treaty provisions because when an arrangement is within the limits of the SAAR, it should

[54] Lang 2014 'BEPS Action 6: Introducing an Antabuse Rule in Tax Treaties' Tax Notes International v. 74. N. 7 p. 658.

[55] *Paragraphs 1 to 7 and 9 refers to Article 29 of the 2017 OECD Model.*

[56] OECD 2017, 'Model Tax Convention on Income and on Capital' Condensed Version 2017, OECD Publishing. http://dx.doi.org/10.1787/mtc_cond-2017-en p. 588.

[57] De Broe & Luts 2015 'BEPS Action 6: Tax Treaty Abuse' Intertax, v. 43, Issue 2, Kluwer Law International B.V., The Netherlands, p. 133.

never be considered abusive.[58] In addition, the LOB provisions could become irrelevant because it would have no justification for the description of specific situations if after all the tax authorities could rely on the general provision to deny the benefits even if the taxpayer is within the limits of the SAAR[59].

An alternative interpretation of the 'Notwithstanding…' affirms that this reference is made to the distributive rules of the treaty in general, rather than with the LOB provisions. The author supports its statement in the fact that even in treaties that do not contain SAARs the GAAR starts with the 'notwithstanding…' formula. This means that the benefits pretended by the taxpayer are denied notwithstanding the provision of the convention applicable to the specific situation.

The author points out that this interpretation would be more consistent with the position adopted by scholars, and in accordance with general principles. Nevertheless, recognizes that this position would be in contradiction with the clear positioned interpretation contained in the OECD Commentaries that was already mentioned[60].

3.2.1 Reasonable test and principal purpose test

The PPT is applied if 'it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction'. Here two elements for its application are introduced: the reasonableness and the principal purpose test[61]. These two elements are considered the principal source of

[58] Baez Moreno 2017, 'GAARs and Treaties: From the Guiding Principle to the Principal Purpose Test. What Have We Gained from BEPS Action 6?' Intertax, v. 45, Issue 6/7, Kluwer Law International B.V., The Netherlands, p. 441.

[59] Lang 2014, 'BEPS Action 6: Introducing an Antiabuse Rule in Tax Treaties' Tax Notes International, v. 74, N. 7 Tax analysts, p. 658.

[60] Baez Moreno 2017, p. 441.

[61] Weber 2017, 'The Reasonableness Test of the Principal Purpose Test Rule in OECD BEPS Action 6 (Tax Treaty Abuse) versus the EU Principle of Legal Certainty and the EU Abuse of Law Case Law', Erasmus Law Review, No. 1 - doi: 10.5553/ELR.000081, p. 49.

uncertainty for the taxpayers because it constrains their ability to know beforehand if they would be entitled to a benefit, or if that benefit is going to be limited by the tax authority[62].

To determine if the reason to enter into any transaction is to obtain the benefits of a specific treaty, an objective analysis should be assessed in each situation considering all the facts and circumstances that surround it. This analysis does not require conclusive proof by the tax authority. The benefits could be denied if after the study of the specific situation it could be reasonable to conclude that the taxpayer has entered into the arrangements with the principal purpose of obtaining those benefits[63]. A great deal of discretion is conferred to the tax authority by reason of the low standard of proof set by the rule[64].

It has been pointed out that the controversial interpretation of the reasonable test occurs because the text of the PPT rule and the OECD Commentaries suggests both a broad and narrow approach towards the arrangement[65]. In the text, it is enough to arrive at a 'reasonable conclusion' that the principal purpose is to obtain the benefit, it is not required to have conclusive proof by the tax authorities. However, in the OECD Commentaries, it is stated that it should not be lightly concluded that obtaining the benefit was one of the principal purposes, and that it is not enough to arrive at this conclusion by merely reviewing the effects of an arrangement[66]. This contradiction hinders taxpayers being able to define beforehand the legal consequences of their tax planning decisions.

3.2.2 Subjective element

One of the most criticized features of the rule has been the subjective requirement. Mainly for difficulties in identifying the taxpayer intentions but particularly with reference to the 'one of the principal purposes' formula. Indeed, securing the tax benefit does not need to be the sole or even the main purpose of the arrangement, it is sufficient that it is one of the principal purposes. Therefore, if there are material economic business reasons that drive the arrangement in conjunction with tax reasons, then the benefits could be denied by the tax authorities because

[62] Cunha 2016, 'BEPS Action 6: Uncertainty in the Principal Purpose Test Rule', Global Taxation, v.1, p. 61.

[63] Cunha 2016, p. 49.

[64] Ibidem, p. 62.

[65] Danon 2018, p. 44.

[66] Weber 2017, p. 49.

one of the principal purposes of the arrangement is the tax reason. Consequently, the material reasons are completely ignored by the fact that there are also tax reasons for instrumenting that transaction[67]. This is particularly questioned because from a doctrinal point of view it contests the existence of treaty abuses when there are business reasons that are of equal importance to the securing of a tax benefit[68].

At the same time, there is no clear explanation about what principal purposes and secondary purposes are and the way in which principal purposes are weighted. Moreover, there will be considerable difficulties because the rule is not going to be interpreted by a unique Court that would set interpretation lines. There are going to be Courts of several jurisdictions deciding on the matter, thus making it more difficult to have a common understanding in the application of the subjective criteria[69].

For Baez, the problem with the subjective test is not the difficulty in determining the intention of the taxpayer but the fact that intention should not be an element of the tax law[70]. For the author, the basics of tax law imply that legal events are linked to pure objective factors – ability to pay, the creation of income, etc. and therefore legislators should never attribute relevance to the intention of the taxpayer. This is because a subjective law could treat two taxpayers that are in the same factual position differently only because of the different demonstrated intentions of them. The author suggests that this breach in tax law could collide with constitutional principles of different jurisdictions[71].

Cunha explains that the rule is vague because it gives tax authorities a margin of appreciation. The concept of what is a principal purpose and what is an abusive arrangement are going to be determined on a case by case basis. The rule does not provide objective criteria (ascertainable by a third party) in order to determine what is principal and secondary and what is abusive and what is not. Therefore, the rule fails to provide 'sufficiently clear, precise and predictable' standards to comply with the principle of legal certainty[72].

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[67] Danon 2018, p. 44.

[68] Kok 2016 'The Principal Purpose Test in Tax Treaties under BEPS 6' Intertax, v. 44, Issue 5, Kluwer Law International B.V., The Netherlands, p. 408.

[69] Lang 2014, p. 659.

[70] Ibidem, p. 658. In the same sense establishes that the intentions are impossible to prove and therefore the legislator avoid assigning consequences to subject's intentions in fiscal law.

[71] Baez Moreno 2017, p. 436.

[72] Cunha 2016, p. 61.

The author analyses an interesting case of 2013 in which the discussion about the 'principal purpose' wording has been studied by the French Constitutional Court. The Court declared it unconstitutional that a law attempted to replace the 'exclusive purpose' for the 'principal purpose' in a domestic GAAR. The decision was based on the consideration that the modification of the wording had the effect of giving an important margin of appreciation to the tax officers. Therefore, the pretended modification infringed among others: a) the principle of legality in tax matters; b) the objective of constitutional value of accessibility and intelligibility of the law which requires to the legislator the adoption of sufficiently precise terms and unequivocal formulas that protect citizens against interpretations contrary to the Constitution and arbitrariness; and c) the principle that establishes the prohibition of delegation of task that the Constitution entrusted to the law in administrative or judicial bodies[73].

It is important to consider that due to the inclusion of the terms 'directly or indirectly' the subjective criterion does not necessarily lie directly with the taxpayer who asks for a benefit. If for example, a transfer of an income source to a related company resulted in a benefit to the receiving company the intention of the transferring company could result in the denial of the fiscal benefits to the third individual (the receiving company)[74].

The terms 'arrangement or transaction' should be interpreted broadly so as to include any agreement, scheme transaction or series of transactions in relation to the taxable object or subject. Arrangements or transactions in relation to the taxable object (the item of income or its underlining asset) or the taxable subject[75].

3.2.3 Denial of benefits

There are many questions among scholars if the term 'benefit' is related to the benefits of one contracting state or the total tax burden carried out by the taxpayer. Regarding this aspect, the OECD Commentaries point out that the term includes all limitations on taxation imposed on the state of source under distributive rules, the relief of double taxation and the non-discrimination protections.[76]

[73] Ibidem, p. 62.

[74] Lang 2014, p. 659; De Broe & Luts 2015, p. 133.

[75] De Broe & Luts 2015, p. 133.

[76] OECD 2017-II, p. 859.

Palao points out that it is obvious that the benefits denied are only those included in the treaty that contains the PPT rule and no other treaty or domestic legislation benefits[77]. The author affirms that the treaty provisions do not confer benefits on their own, but only in connection with distributive rules which are out of the scope of the limitation of the PPT rule[78]. Lang goes beyond this by clarifying that the rules of information exchange and mutual enforcement assistance and any other procedural provision that serves to enforce treaty provisions, in general, do not bring a benefit for the taxpayer[79].

Once the denial of benefits has been established, there is the problem of determining the adequate tax treatment of those arrangements or transactions improperly used, and the PPT rule and the OECD Commentary give no clue in that respect. There is no regulation or comment on the effect in the residence state of the application of the PPT rule by the source state or even for more complicated cases like those in which three or more countries are concerned. For Palao, the only alternative way to solve this issue is for states to use the mutual agreement procedure[80].

As indicated, the rule does not include any provision indicating which state would be entitled to tax. In consequence, if a source state denies a benefit through this provision to a taxpayer and the residence state does not gives a credit for the tax paid - double taxation would arise. This could result in the PPT rule having a penalizing effect. Another possibility is the creation of a fiction to re-establish the facts of taxation, but for Lang, this would lead to 'seemingly arbitrary and thus unsatisfactory consequences'[81].

The rule is not clear about the legal consequence of its application and therefore again the problem of uncertainty is present in the wording leading to a great deal of insecurity to taxpayers[82].

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[77] Palao 2015, p. 606. In the same position Lang 2014, p. 656.

[78] Ibidem, p. 606.

[79] Lang 2015, p. 657.

[80] Palao 2015, p. 606.

[81] Lang 2015, p. 662-663.

[82] Koriak 2016, 'The Principal Purpose Test under BEPS Action 6: Does the OECD Proposal Fit the EU Legal Framework?' Lund University, p. 13.

3.2.4 Objective element

In the rule, there is a second standard for the determination of the existence of an abusive practice which is the objective element[83]. This is contained in the last part of the wording of the rule: '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'. The objective test allows the taxpayer to prove that the granting of the benefit is in accordance with the treaty provision and therefore to demonstrate that the intention of the contracting states in the Tax Convention is not frustrated if the benefit is conferred[84].

In this regard, many scholars have pointed to the uneven burden of proof between the tax administration and the taxpayer[85]. To initiate the procedure the tax administration has to demonstrate that it is 'reasonable' that the principal purpose of the arrangements is to obtain the benefits. Once faced with this conclusion the taxpayer, however, has to 'establish' – to convincingly demonstrate – that granting the benefit is in accordance with the object and purpose of the relevant provision[86].

As previously mentioned, the word 'reasonable' sets a very low standard of proof for the tax administration thus increasing the margin of discretion. It is only necessary to produce evidence that shows that the decision is justifiable. Cunha notes that the term reduces the intensity of the scrutiny carried out by Courts[87].

The object and purpose of the provision should be searched in the treaty itself, including all provisions, the preamble and the title[88]. Here it is important to remember the ongoing process of modification of the title and the preamble introduced by the MLI. It is also suggested that

[83] Baez Moreno 2017, p. 436.

[84] Koriak 2016, p. 11.

[85] De Broe & Luts 2015, p. 133; Lang 2014, p. 658; Danon 2018, p. 42.

[86] Chand 2018 'The Principal Purpose Test in the Multilateral Convention: An in-depth Analysis', Intertax, v. 46, Issue 1, Kluwer Law International B.V., The Netherlands, p. 21; De Broe & Luts 2015, p. 133; Lang 2014, p. 661, Kok 2016, 409.

[87] Cunha 2016, p. 62.

[88] Baez Moreno 2017, p. 437.

the object and purpose could be found in the Commentaries of the Model Convention and the reservations made by contracting states[89].

For Baez, the restrictive wording of the objective element limited to the 'treaty provisions' instead of the 'treaty itself' leads to inconsistencies and interpretative problems[90]. That difficulty could end up in the replacement of the reference 'treaty provisions' for 'the general purpose of the treaty' by the interpreter[91]. This, apart from being a deviation of what the text of the rule establishes, would imply more complicated problems for the application of the rule. Once determined that one of the principal purposes of any particular transaction was to obtain a certain benefit it should be decided if the granting of that tax benefit is in accordance with the object and purpose of the treaty. Since it would have been incorporated in the title of the treaty that one of the purposes of it is to prevent tax evasion and avoidance it would be automatically concluded that the arrangement is of an abusive nature[92].

For De Broe & Luts the change of reference from the object and purpose of the 'treaty provision' to the 'treaty itself' still presents difficulties to the taxpayer because the intentions of treaty partners is rarely accessible for the general public leaving the only alternative to try to find the object and purpose in the OECD Commentaries[93].

Chand points out that in an avoidance scheme the formal conditions are always in accordance with the object and purpose of the relevant provision. Therefore, the author states that the application proposed by the wording of the rule would make it redundant by itself because the

[89] Kok 2016, p. 409.

[90] Baez Moreno 2017, p. 436 - 437. The author points out that in treaty shopping structures the treaty provisions that are at stake are Art. 1 to 4 of the relevant treaty. Therefore, it would be necessary to determine whether obtaining of the treaty benefits is in accordance with the object and purpose of the concept of resident. The concept of resident has various functions, and it seems evident that the application of the Convention to insubstantial arrangement would be in accordance with the object and purpose of the resident concept. In the case of rule shopping the application of the objective element would require the existence of a teleological design behind distributive rules pointing that double treaty conventions lack of underlying logic because usually are the result of a negotiation process between contracting states.

[91] Ibidem, p. 436.

[92] Ibidem, p. 440.

[93] De Broe & Luts 2015, p. 133.

taxpayer would always satisfy that requirement. Chand form part of the scholars that advocates for the application of the rule considering the tax treaty context and object and purpose of it[94].

3.2.5 OECD Commentaries Examples

According to Lang, the hope that the OECD Commentaries examples could be used to mitigate the effects of the rule overlooks the fact that tax administrations and courts will be applying the wording and not the Commentaries. The author states that beyond the discussion of the role of the Commentaries in the interpretation of rules 'its importance will never match that of a treaty provision'[95].

Danon takes another position and based on the OECD Commentaries examples affirms that usually treaty benefits are not denied when genuine business activities are carried out by the taxpayer[96]. The author does not overlook the divergence between the wording of the rule and what is illustrated in the OECD Commentaries expressing that it is not the ideal situation from a legal certainty perspective. Nevertheless, it is pointed out that the OECD Commentaries 'clarify that the PPT rule is, in essence, a business reality test focusing on substance' and concludes that treaty benefits should not be denied in the case of the arrangement or transactions are 'predominantly and extrinsically linked to a core commercial activity'[97].

The author then provides more details, pointing to examples that support the above-mentioned position. In example C, a company that produces electronic devices is considering establishing a production plant in a developing country to reduce its manufacturing costs. After the review of many locations the final decision is based upon the jurisdiction in which the country of residence of the company has a tax treaty. In this example the Commentaries state that it is not reasonable to conclude that the principal purpose of the investment is the securing of treaty benefits but rather the expansion of the business, and the reduction of the production costs[98].

Example G focuses on the importance of local substance. From example K is deducted by the author that substance is one of the most important elements for the taxpayer to demonstrate that

[94] Chand 2018, p. 24.

[95] Lang 2014, p. 660.

[96] Danon 2018, p. 48.

[97] Ibidem, p. 50.

[98] Ibidem, p. 48.

the subjective element of the PPT rule is not satisfied. In this example the availability of directors with knowledge of regional practices and the existence of a skilled multilingual workforce, performance of various functions such as approving or monitoring investments, carrying on treasury functions, maintaining of books and records and ensuring compliance are mentioned. This example is used to demonstrate that core business activities are behind the election of that jurisdiction instead of treaty benefits[99].

3.3 Conclusions

Since it is not required by the PPT rule to demonstrate that the existence of artificial arrangements by the tax authority, the objective test is an exception, and it would presumably be very difficult for the taxpayer to establish that the benefit is in accordance with the object and purpose of the treaty. Therefore, the subjective test becomes the decisive part of rule. On top of that, the subjective test does not require the tax administration to provide conclusive evidence but rather to reasonably conclude that the arrangement used by the taxpayer is for obtaining tax benefit. Considering this, it is possible to conclude that the rule is not in accordance with basic principles of tax law, and it sided in favor of tax authorities giving the broad powers in the resolution of the question. However, if in practice it is demonstrated that the application of the PPT rule follows the OECD Commentaries examples those assumptions could be mitigated.

The PPT rule appears to contradict the right of the taxpayers to organize their business in the most efficient way. It is difficult to think that cross-border enterprises when structuring their material business would not take into account the tax considerations as one of the decisive elements. The application in a broad way of the rule could result in tax authorities applying the rule to any form of tax planning including situation in which genuine business reasons are considered as well as the tax benefits of the arrangement. Another possibility is that taxpayers unilaterally decide not to claim treaty benefits even if they have genuine business reasons to avoid the uncertainty that the rule could place in their regular activity.

Considering the doubt and uncertainties that the rule creates, and without denying the fact that in the end the application of the PPT rule would depend on precise facts and circumstances of each case, Chand lists requirements that new arrangements or transaction should comply with

[99] Ibidem, p. 48.

in order to reduce contingencies. Taxpayers using intermediary entities should: a) outline the business reasons for the introduction of the intermediary; b) provide non-tax reasons for being located in a particular jurisdiction; c) board of directors integrated by local qualified tax residents; d) regular meetings of the board playing an active role in the intermediary entity; e) local specialist staff are in charge of the day to day core activities of the entity - ensuring that the board and staff control the financial affairs of the entity; f) autonomous use of income received; and, g) the entity has the necessary equipment to carry on its activity[100].

[100] Chand 2018, p. 41.

Section IV – GAAR at the EU Level

4.1 Introduction

Before addressing the anti-avoidance rule introduced in the ATAD the concept of abuse of rights in correlation with the tax avoidance concept at EU level is studied. For that reason, the attention is centered on the evolution of the case law of the European Court of Justice. The development of the concept of abuse of law in the EUCJ case law is primarily based on the leading cases Emesland-Stärke, Halifax, Cadbury Schweppes and Thin Cap which are presented in this Section. Additionally, later cases are going to be analyzed to attend posterior evolution and confirmation of the concept that was given in the previously mentioned cases. After that, this Section of the thesis study is focused on the GAAR introduced in the ATAD by analyzing their elements and composition: subjective and objective elements and the consequences of its application when confronted with an abusive transaction.

4.2 Development of the concept of Abuse of Law in the EU Case Law

The notion of abuse of law appears for the very first time in the case law of the EUCJ in 1974 to state that EU Law cannot be relied on for abusive or fraudulent proposes. However, it was not until 2000 in the Emesland-Stärke Case that the EUCJ started to determine an adequate criterion to ascertain whether abuse of law takes place[101]. The judgement was related to the exportation of agricultural products to Switzerland and its immediate reintroduction to the EU with the purpose of taking advantage of the grant of export refunds[102]. In that case, the Court stated that the existence of abuse requires a combination of objective circumstances, even though the formal application is in accordance with Community law, the purpose of those rules is not achieved. The other element for the determination of abuse is the existence of a subjective element which is the intention of obtaining an advantage by creating artificial conditions[103].

[101] De Broe & Beckers 2017 'The General Anti-Abuse Rule of the Anti-Tax Avoidance Directive: An Analysis Against the Wider Perspective of the European Court of Justice's Case Law on Abuse of EU Law', EC Tax Review, 2017-3, Kluwer Law International BV, The Netherlands, p. 133.

[102] EUCJ Case C-110/99, Emesland-Stärke, 19/12/2000.

[103] De Broe & Beckers 2017, p. 133.

Further evolution of the abuse of law concept and the process to deal with it is issued by the EUCJ in the cases Halifax and Cadbury Schweppes. The last mentioned has become the leading case in the determination of inadmissible abusive transactions on the one hand, and what is still considered admissible tax mitigation[104].

4.2.1 Landmark cases

In Halifax, the EUCJ applied the concept of abuse of EU Law in the field of VAT (indirect taxation). The Court stated that an abusive practice could be found to exist only if two conditions are met. First, the transaction concerned notwithstanding the formal application of the conditions laid down by the rule result in securing a tax advantage which the granting of it would be contrary to the purpose of that provision. Second, it must be apparent from a number of objective factors that the essential aim of the transaction or series of transactions was the securing of a tax advantage. The prohibition of abuse is not relevant if the transaction entered is explained by other reason than the attainment of the tax advantages[105]. The Court stated that taxpayers might structure their business so as to limit their tax liability. However, this could not imply taxpayers are engaging themselves in abusive practices in the form of transactions carried out with an essential or sole purpose of obtaining tax advantages contrary to the purpose of the provision at stake[106]. The reference made by the Court to the 'essential aim of the transaction' implies that transactions that are entered into for a reason different than the mere attainment of a tax advantage are not abusive[107].

Cadbury Schweppes is a case in which the Court ruled in the context of CFC rules. However, the principles set out have been applied in regard to other cases regarding anti-abuse rules. In that case, it is stated that Member State's CFC regime which restricts the freedom of establishment could be justified on the basis of prevention of tax avoidance and evasion yet only in regard of wholly artificial arrangements that were entered with the intention of circumventing the application of the legislation of the Member State concerned. It was also

[104] Cordewener 2017 'Anti-Abuse Measures in the Area of Direct Taxation: Towards Converging Standards under Treaty Freedoms and EU Directives?', EC Tax Review, 2017-3, Kluwer Law International BV, The Netherlands, p. 62.

[105] De Broe & Beckers 2017, p. 134.

[106] Poulsen 2013 'Treaty/Directive Shopping and Abuse of EU Law' Intertax, v. 41, Issue 4, Kluwer Law International B.V., The Netherlands, p. 242.

[107] Ibidem, p. 242.

ruled that any restrictive anti-abuse rule must be proportional and has to exclude from their scope situations that are entered into for tax motives but at the same time reflects economic reality taking into account the objective circumstances[108].

From this decision follows that 'forum shopping' is legitimate within the EU and tax considerations could be valid for a company to take the decision to establish a subsidiary in another Member State. Additionally, it is a clear message that if the Member States want to prevent the loss of revenue by instrumenting anti-abuse rules, it must target abusive situations specifically[109].

The Member States must accept that taxpayers could take advantage of more favorable tax regimes in the other Member States. However, what they are not obliged to accept is the artificial transfer of income generated in the territory of one Member State to a lower tax jurisdiction[110]. When transactions are wholly artificial, the objective of reducing taxation becomes relevant. In that case, the object of the fundamental freedoms is not achieved since that transaction does not result in the effective integration of economic activities among the Union. If those objectives are fulfilled there cannot be tax avoidance even when reducing the tax burden would be the only purpose of the transaction[111].

In Cadbury Schweppes, the Advocate-General developed a negative definition of the concept of 'wholly artificial arrangements' that was confirmed by the EUCJ. The existence of a tax reduction motive is too subjective a criterion for the determination of the existence of artificiality of the arrangement. The level of taxation, like other legitimate motives, like labor cost, is a factor that companies can take into account when selecting a jurisdiction to develop economic activity. The negative definition of the concept of 'wholly artificial arrangements' consists of three objective criteria for situations in which the arrangements are not artificial. The first is the one that establishes that the subsidiary must be genuinely established and must have the substance and the capability of conducting the services from which the tax advantage

[108] Panayi 2016 'The Compatibility of the OECD/G20 Base Erosion and Profit Shifting Proposals with EU Law', Bulletin For International Taxation January/February 2016, IBFD, p. 95.

[109] Poulsen 2013, p. 239.

[110] Ibidem, p. 239.

[111] Vanistendael 2006, 'Halifax and Cadbury Schweppes: one single European theory of abuse in tax law?', EC Tax Review, 2006/4, Kluwer Law International BV, The Netherlands, p. 195.

is obtained. The second states that the services performed by the subsidiary must be genuine in nature. The subsidiary must not be a mere tool of execution but have the staff and the resources necessary for the provision of the service and the powers of making decisions in regard of those services. Lastly, the subsidiary's services from the perspective of the parent company must have some economic value. If those services have no economic value, the parent's payments for them cannot be considered a payment for consideration but a fictitious payment. If those three criteria are not met then the arrangement could be considered a 'wholly artificial' one[112].

As was previously mentioned, it was established in Cadbury Schweppes by the EUCJ that any restrictive anti-abuse measure must be proportional. Therefore, situations in which a taxpayer takes advantage of a lower tax jurisdiction must be excluded from the scope of its application when the arrangements put in place reflect economic reality[113]. The proportionality requirement was further developed by the Court in Test Claimants and Thin Cap Group cases establishing that the taxpayer had to be given the opportunity to provide evidence that justifies the commercial reason/s for entering into that arrangement, without being subject to undue administrative constraints[114]. At the same time, it was established that the adjustments to the taxable income as a result of the application of the anti-abuse measures should be limited to the extent of what is attributable to the purely artificial arrangements. Meaning, in regard of intra-group transactions the application of the arm's length principle[115].

Particularly analysis is required with regard to the subjective element. The Court has not been consistent in its case law, using various terminologies like sole, essential, principal and predominant purpose. In Park Service the Court established that in any event, the transaction which has the sole purpose of obtaining a tax advantage is the minimum threshold for classifying a practice as abusive. In Foggia the Court stated in this matter that the argument

[112] Prebble & Prebble 2008, 'Comparing the General Anti-Avoidance rule of Income Tax Law with the Civil Law Doctrine of Abuse of Law', Bulletin For International Taxation April 2008, IBFD, p. 163.

[113] Panayi 2016, p. 100.

[114] Ibidem, p. 100.

[115] Commission of the European Communities 2007, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, 'The application of anti-abuse measures in the area of direct taxation – within the EU and in relation to third countries', p. 5.

put forward by the taxpayer when demonstrating that the arrangement was entered for valid commercial reason must not be 'marginal'. Defences based on trivial or negligible arguments are not enough to exclude the abusive practices which were entered with the 'sole purpose' of obtaining a tax benefit[116].

4.2.2 The influence of EUCJ case law in the EU GAAR framework

As a consequence of the development of the case law of the EUCJ, it was concluded that in the process of designing anti-abuse rules Member States should take into account that those measures are not to be drafted in a broader way if it is incompatible with the freedom of establishment guaranteed by the European Community Treaty. The rules must be drafted in a way that combats only arrangements which do not reflect economic reality, that are wholly artificial and entered into with the sole purpose of avoiding taxation[117].

In subsequent cases Eqiom and Deister/Juhler it was confirmed by the Court that: a) article 1(2) of the Parent-Subsidiary Directive reflects the general EU law principle that abuse of rights is prohibited, b) the burden of proof in a potential abusive situation cannot be assigned entirely to the taxpayer, c) the definition provided by the Court in the Cadbury Schweppes case law is still in place, d) the given definition of abuse can be transposed in relation of the Parent-Subsidiary Directive, and finally e) the establishment of a holding company in another Member State does not constitute in all cases abuse[118].

More recently the Euro Park Service case has been classified as a door opener for the introduction of the abuse of law doctrine into other harmonized areas of EU Law[119].

To sum up, it is settled case law of the EUCJ that in the absence of a harmonized tax system taxpayers must be able to make use of the one most beneficial to them. That means that taxpayers are entirely free to move their residence or the source of income to another member state. At the same time Member States are entitled to adopt anti-abuse rules which in any case

[116] De Broe & Beckers 2017, p. 134.

[117] Prebble & Prebble 2008, p. 163; De Broe & Beckers 2017, p. 135.

[118] Bundgaard & Koerver 2018 'When Are Domestic Anti-Avoidance Rules In Breach of Primary and Secondary EU Law? – Comments Based on Recent ECJ Decisions', European Taxation April 2018, IBFD, p. 136.

[119] Cordewener 2017, p. 64.

could not be contrary to primary and secondary EU law. Restrictive and discriminatory measures are only justified if they are taken in the general interest and must be proportional. Anti-abuse rules are proportional if are: a) suitable to attain the objective that pursue; and b) do not go beyond what is necessary in relation to the accomplishment of the object that the anti-abuse rule have[120].

The justification for anti-abuse rules is the necessity to prevent tax evasion and avoidance in cases where the use of wholly artificial arrangements (lacks economic reality), and whose sole or principal purpose is the attainment of a tax benefit. In other terms, arrangements that do not have any other explanation from an objective perspective but to obtain a tax advantage[121].

To comply with EU law the anti-abuse measures must have certain features: a) they must be based on the subjective-objective test and the tax authority must bear the burden of proof, yet it can rely on legal presumptions; b) consequently, broad and general presumptions of abuse are not allowed, and a case-by-case assessment is necessary to be conducted in the determination of the existence of abusive behavior; c) in any case the taxpayer must have the opportunity to demonstrate, without being subject to any administrative constraints, that the arrangement was put in place for valid commercial reasons; d) when the use of an abusive arrangement is detected the redetermination of the transaction should be limited to the reestablishment of the situation that would have prevailed in the absence of the abusive scheme; and e) to be proportional the anti-abuse rule should respect the principle of legal certainty which means that it must be clear, precise and predictable in relation to its effects[122].

4.3 Background of the ATAD-GAAR

In the 2016 Communication to the European Parliament and the Council the European Commission it was stated that aggressive tax planning is a problem that requires EU and Global coordination because a unilateral action would generate additional problems. In that Communication it was affirmed that pending the adoption of the CCCTB proposal, which

[120] De Broe 2016, 'Tax treaty and EU Law aspects of LOB and PPT Provision', Danon (ed.) Base Erosion and Profit Shitting (BEPS), Impact for European and International Tax Policy, Schulthess, p. 226, 227.

[121] Ibidem, p. 228, 229.

[122] Ibidem, p. 229, 230.

contains several anti-abuse measures including a GAAR[123], it was necessary for the enactment of measures in the immediate term for strengthening EU tools for coordination. Those measures consisted of an Anti-Avoidance Package in which was included the Anti-Avoidance Directive proposal[124].

In the recitals of the Directive it is stated that the function of the GAAR is to tackle abusive tax practices that have not yet been dealt with through the specific anti-abuse rules. Therefore, the GAAR has function of filling in the gaps. The GAAR should be applied to arrangements that are not genuine; otherwise, the taxpayer should have the right to choose the most tax efficient structure for its commercial affairs. Another purpose stated is the importance of ensuring the application of the GAARs in domestic situations, within the Union and third countries in a uniform manner, so that their scope and results of application in domestic and cross-border situations do not differ[125].

The GAAR contained in the ATAD, which was approved on July 12, 2016, was amended in the negotiation process to make it aligned with the GAAR contained in the Parent Subsidiary Directive. The ATAD GAAR is a minimum standard required for Member States to tackle tax avoidance. The Member States that did not have a similar GAAR provision in force will have to enact a EUCJ developed concept by transposing the ATAD GAAR to their domestic law[126].

4.4 Analysis of the wording of the ATAD provision

The rule is worded as follows:

> *General anti-abuse rule*
> 1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax

[123] Rigaut 2016, 'Anti-Tax Avoidance Directive (2016/1164): New EU Policy Horizons', European Taxation November 2016, IBFD, p. 498.

[124] European Commission 2016, Communication from the Commission to the European Parliament and the Council, 'Anti-Tax Avoidance Package: Next steps towards delivering effective taxation and greater tax transparency in the EU', p. 3, 8.

[125] Council Directive (EU) 2016/1164 of 12 July 2016, paragraph 11. Published in the Official Journal of the European Union on 19 July 2016 and entered into force on 9 August 2016.

[126] Rigaut 2016, p. 502; De Broe & Beckers 2017, p. 140.

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

From the wording it follows that the GAAR is applicable when: a) an arrangement or series of arrangements; b) are put into place for the main or one of the main purposes of obtaining a tax advantage; c) that break down the object or purpose of the applicable law; d) which are not genuine once considered all the relevant fact and circumstances[127].

Smit considers that the GAAR entails three cumulative tests which are: i) artificiality, ii) motive, and iii) defeat of object and purpose of corporate tax law.[128]

The first part of the GAAR contained in the ATAD determines the scope of application of the rule in regard of the calculation of the 'corporate tax liability' and which differentiates this GAAR to the one contained in the PSD along with the consequences of the application. In the GAAR object of this thesis the consequence is the recalculation of the tax liability and in the one contained in the PSD is the limitation of the benefits. In the rest of the composition of the wording it is determined that both are identical rules[129].

In the ATAD GAAR there is no direct mention regarding the inclusion of withholding taxes on dividends which made some authors doubt if the scope of the rule may include it[130]. During the negotiation for the approval process the explicit inclusion of the reference to withholding taxes was requested by some delegations to make clear that such abuses would be included in

[127] De Broe & Beckers 2017, p. 141.

[128] Smit 2018, 'The mandatory General Anti-Avoidance Rule (GAAR) for Corporate Taxation', Terra & Wattel European Tax Law, Volume 1, General Topics and Direct Taxation, 7th Student Edition, Fed Fiscale Studieserie, Wolters Kluwer, p. 271.

[129] Rigaut 2016, p. 502.

[130] Dourado 2016, 'The EU Anti-Tax Avoidance Package: Moving Ahead of BEPS?' Intertax, v. 44, Issue 6&7, Kluwer Law International B.V., The Netherlands, p. 442.

the scope of the GAAR. The point was the object of argument because in some domestic legislation of Member States the withholding taxes would be covered under corporate taxation, but not in others. The change was supposed to affect the scope of the ATAD and for that reason it was agreed that each Member State would clarify the point when transposing the rule to their national legislation[131].

4.4.1 Subjective element

The rule contains a subjective test which is determined by the fact that the arrangement or series of arrangements are put in place 'for the main purpose or one of the main purposes of obtaining a tax advantage'. According to this wording, it is sufficient that one of the main purposes is obtaining the tax advantage for the arrangement to be covered by the rule. It is not required that the attainment of the tax advantage to be the main, sole or essential purpose of the arrangement. This wording is presented as having a very low (subjective) abuse threshold[132]. Apparently, not even the existence of substantial and valid economic reasons behind the structure appears to be enough of excluding the application of the GAAR that remove the advantage obtained.

Authors Debelva & Luts, however, based on the interpretation of the EUCJ rulings advocates an interpretation of the subjective test in a way as constructed for the attainment of the tax advantage as the sole or predominant purpose of the arrangement/s. In Kofoed case, the authors point out that when interpreting the anti-abuse rule of the Merger Directive the Court established that the intention of the rule, is to capture abusive practices. The interpretation that is in accordance with the Community law principle that abuse of a right is prohibited. Abusive practices were defined as transactions carried out not in the context of normal commercial operations but for the sole purpose of obtaining advantages provided by Community Law. Foggia case is also cited by the mentioned authors to support their statement: 'when an arrangement is motivated by several objectives, which may also include tax considerations, no abuse is presently provided, however, that those considerations are not predominant in the context of the proposed transaction'[133].

[131] Rigaut 2016, p. 503; De Broe & Beckers 2017, p. 141.

[132] Debelva & Luts 2015 'The General Anti-Abuse Rule of the Parent-Subsidiary Directive', European Taxation June 2015, IBFD, p. 225.

[133] Ibidem, p. 225.

Smit points regarding the subjective element that in the case law of the EUCJ the motive test appears to be subordinate to the artificiality test because usually, taxpayer's motives are difficult to establish. Since this difficulty is presented the Court moves to look at objective elements which are ascertainable by third parties (absence of economic substance, derogation from arm's length standard, among others) that indicate on the taxpayer's (assumed) intention. Therefore, the taxpayer's motive is inferred from objective facts and circumstances which are difficult or impossible to explain if it was not for the attainment of a tax benefit. Finally, the author points to the fact that the motive test operates as a rebuttal possibility. If the fact patterns look like a tax avoidance set up, the taxpayer may demonstrate the contrary by pointing out significance non-tax purposes[134]. However, those other considerations presented by the taxpayers as a defence could not be in any case marginal, trivial or negligible following the EUCJ case law reasoning[135].

4.4.2 Objective element

The objective element is given by the fact that advantage obtained 'defeats the object or purpose of the applicable tax law'. That determination could not be stated in the abstract, yet it is necessary to conduct a case-by-case assessment considering the object and purpose of the domestic corporate tax provision at stake[136]. Therefore, the ultimate goal of tax provision has to be determined by the interpreter. This is considered to be not always an easy task, especially when the drafting history or preparatory documents do not exist or if they do, they are not clear enough or are ambiguous[137]. The acting court must define the object and purpose of the applicable law which will be determined by what law is at stake. In situations of purely national legislation the competence is within the national Court of the Member State, and when a provision of EU Law is at stake, the competence is going to be exercised by the EUCJ[138]. Second, the interpreter should then determine if the tax advantage obtained, despite the formal observance of the letter of the law, frustrates the intent of the legislator in the given circumstances[139].

[134] Smit 2018, p. 272.

[135] De Broe & Beckers 2017, p. 142.

[136] Smit 2018, p. 273.

[137] De Broe & Beckers 2017, p. 142.

[138] Ibidem, p. 143.

[139] Debelva & Luts 2015, p. 226, 227.

Smit points out that the mere use of mismatches between the corporate tax systems of different Member States is out of the scope of the ATAD GAAR. The author based his position on the fact that the tax advantage is not attributable to the tax law of one single state as such. It is necessary to resort to specific tax avoidance rules to tackle those improper benefits[140].

Regarding the object and purpose of the national legislation, authors have raised concerns in relation to the fact that frequently corporate tax rules do not have any other evident purpose than raising revenue[141]. To work appropriately, the GAAR should relate back to the underlining law. For that reason, rules should be drafted carefully with a clear expression of the principles against which the alleged abuse could be tested[142]. Consequently, the GAAR could become senseless when the given rule lacks a purposive element. This could result in the interpreter coming to an unreasonable conclusion that best complies with the purpose of that rule. This implies that the taxpayer should adopt the most burdensome alternative to conduct business. This effect has been called 'cash justice'[143].

4.4.3 Artificial arrangements

Cumulative with the subjective and objective elements tax authorities in the application of the ATAD GAAR must consider the nature of the arrangements or series of arrangements. Therefore, it is necessary to establish that the arrangements at stake are 'not genuine' which means that they were not put in place for valid economic reasons. As stated in paragraph two: 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, including financial activities[144]. The wording of the GAAR in this point deviates from the element

[140] Smit 2018, p. 273.

[141] Navarro, Parada & Schwarz 2016, 'The Proposal for an EU Anti-avoidance Directive: Some Preliminary Thoughts', EC Tax Review, 2016/3, Kluwer Law International BV, The Netherlands, p. 124, 125.

[142] Tavares & Bogenschneider 2015 'The New *De Minimis* Anti-abuse Rule in the Parent-Subsidiary Directive' Intertax, V. 43, Issue 8/9, Kluwer Law International B.V., The Netherlands, p. 489.

[143] Navarro, Parada & Schwarz 2016, p. 124, 125.

[144] Smit 2018, p. 271.

established by the case law of the EUCJ which required the arrangement to be 'wholly artificial arrangements'[145].

There is not a definition of the terms 'arrangements or series of arrangements' in the wording of the rule but from the EU Commission documents it has been concluded that a broad interpretation of the term has been given and therefore is considered to include 'transaction, scheme, action, operation, agreement, understanding, promise, or undertaking'[146].

4.4.4 Consequence of the application of the GAAR

Because of the application of the GAAR, as stated in paragraph three of the rule 'the tax liability shall be calculated in accordance with national law'. Therefore, the targeted arrangement must be ignored. Regarding the application of the last part of the provision authors have stated that the term 'ignore' must be interpreted as 'disregard' or 'refuse to recognize'. The abusive arrangements should be simply ignored by the tax authority [147].

The reference contained in the wording proposed by the Commission regarding the re-calculation of the tax liability by reference to the 'economic substance' in accordance with the national law was deleted because some member states do not have that concept within their national law. The new reference only to 'national law' gives complete flexibility for the member states to define the calculation procedure when transposing the provision[148].

Unlike the wording of the PPT rule, there is no special reference that makes the interpreter think about a reversal of the burden of proof[149]. Under the standard division of the burden of proof, the taxpayer would attain the benefits from the arrangement or series of arrangements unless the anti-abuse rule – including the objective test – is fulfilled. Therefore, it is up to the tax authorities to demonstrate that the granting of the benefits is contrary to the object and purpose of the tax legislation at stake[150]. As previously mentioned, in any case, the taxpayer must have the opportunity, without being subject to unreasonable administrative constraints, to provide

[145] De Broe & Beckers 2017, p. 143.

[146] Debelva & Luts 2015, p. 224.

[147] De Broe & Beckers 2017, p. 143.

[148] Rigaut 2016, p. 502.

[149] Smit 2018, p. 274.

[150] Debelva & Luts 2015, p. 227.

evidence of any commercial justification. The Leur-Bloem case stated that general rules that exclude a certain category of operations form a tax advantage, without giving the taxpayer the possibility to prove the contrary, are not permitted[151].

4.5 Conclusions

The ATAD GAAR has been built upon the concept of abuse of law in the taxation context developed in the case law of the European Court of Justice. Even though the wording deviates from the EUCJ concept by introducing the 'main or one of the main purposes' which may lower the threshold of application in comparison with the anti-abuse measures conceived by the Court, the GAAR is intended to tackle pure tax avoidance arrangements with a formula that at the same time gives legal certainty to the taxpayers. For that reason, the burden of proof is on the tax authorities regarding arrangements put in place by the taxpayer, and those arrangements must not have a valid commercial reason. The other element of certainty is that there is an EU case law background that would guide the limits of the application of the rule and give the taxpayer the guidelines for the determination of what would be included in the scope of the anti-avoidance rule.

As other GAARs, this one also has the risk of circular application in cases in which the object and purpose of the rule could not be easily determined or in cases in which it was concluded that the only object and purpose of the rule is the raising of revenue.

On the contrary, some of the legal safeguards in favour of the taxpayer, especially the demonstration of the artificiality of the arrangement or series of arrangements could limit the effectiveness of the rule. This is a side-effect with respect to the principles of EU law which imply that the restriction of the fundamental freedoms is only justified in cases of tax avoidance and with restrictive measures proportionate, that do not go beyond what is necessary. Rules should be clearly stated and be understandable to know beforehand the consequence of the adoption of specific conduct by the taxpayer.

The effectiveness of the rule could also be unintentionally undermined in the process of implementation in domestic legislation. At the same time, this could mean that comparable situations are treated differently within the European Union. However, the interpretation of the implementation corresponds to the EUCJ which would control and guarantee the respect of the EU Law if cases were interpreted inadequately.

[151] Smit 2018, p. 274.

Section V – Analysis and evaluation

5.1 Introduction

The scope of each rule has been established in the previous chapter. In this chapter the author will analyze and evaluate both rules. The similarities and differences of both sets of rules are presented in terms of the possible consequences with regard to the compatibility of the norms. These aspects are further analyzed in relation to the effectiveness of the rules of the OECD and EU ATAD. Regarding the effectiveness of the rule there are two aspects to be considered: a) the rule enforcement despite the flaws contained in it, and its possible counter-productive effect for tax authorities in its application; and b) the fact that the rule does not contain any obligation for states to apply them, being entirely at the political willingness of each contracting state.

5.2 Comparison of the findings of each rule

Having studied both systems of general anti-avoidance regimes separately the author will now address the differences and similarities and determine to what extent these systems are compatible.

The MLI/OECD Model GAAR establishes that 'one of the principal purposes' of the arrangement or transaction is the attainment of the tax advantage. The ATAD uses similar wording in that it is the 'main purposes or one of the main purposes'. The EUCJ case law has referred to the 'essential aim' in VAT cases. Moreover, the Commission's recommendation on aggressive tax planning uses the same wording. However, the Court in cases directly referred to direct taxation (Cadbury Schweppes) have accepted the concept of 'one of the main purposes'. This is the same wording that the PSD uses. Consequently, we consider that the concept of the PPT rule and the ATAD does not differ in substance from the one developed by the Court, and hence the concepts are compatible.

By contrast, substantial differences are identified between both sets of rules in regard to the burden of proof. In the context of the MLI/OECD GAAR tax authorities have to establish that it is 'reasonable to conclude' that one of the principal purposes is the attainment of tax advantages. Therefore, there is a partial inversion of the burden of proof. Once the reasonableness of the argument is established by the tax authority there is a presumption against the taxpayer that must be rebutted by him or her. There is no express reference in the wording of the ATAD GAAR as to the burden of proof which makes the interpreter conclude that the general system of distribution of burden of proof is applied. This means that the burden of

proof is on the party that invokes a fact: if the tax authority invokes that an arrangement or a series of arrangements are not genuine and have been put in place for the main purpose of obtaining a tax advantage then they must demonstrate this. Therefore, it is not sufficient to invoke the fact but must clearly demonstrate it to the competent judge.

Regarding this point much criticism has been made by different authors to the reasonable test, which is included in the PPT rule. Kemmeren has pointed out that it may create great uncertainty for taxpayers which is not acceptable under EU Law. The rule gives great discretionary powers to tax authorities, and from the case law of the EUCJ rules must be sufficiently clear, precise and predictable especially when they may have unfavorable consequences for individuals and companies. If the rules do not meet these requirements they are not considered to be proportionate to the objectives that are being pursued[152].

Another major difference between the PPT rules and the ATAD GAAR is the relevance of commercial justification. This aspect is included in the second paragraph of the ATAD GAAR and reflects the concept that has evolved from the EUCJ case law that an arrangement should be considered non-genuine if it has not been put in place for valid commercial reasons that reflect economic reality. This concept is a waiver for the taxpayer to justify the arrangement or scheme created even if there is also tax motivation. There is no such a rebuttal in the MLI/OECD Model GAAR. It does not provide any protection from the sanction even if the taxpayer could demonstrate that the arrangement has commercial reasons and is justified from an economic perspective[153].

Both rules present the same degree of difficulty in terms of the identification of the object and purpose of the applicable rule. Reference in previous sections has been made to the difficulties that the objective test presents to the taxpayers. In both reference systems they could face similar difficulties. Not all rules contain express reference to the object and purpose that have given rise to its implementation. Usually preparative works are not accessible for the public and that supposes a disadvantageous position for the taxpayer in relation to the tax authorities that in all cases have this information available.

The consequences of the application of both rules are different. The PPT rule implies the loss of all benefits conferred by the treaty and the taxpayer would most likely face double taxation.

[152] Kemmeren 2014, 'Where is EU Law in the OECD BEPS Discussion?' EC Tax Review, 2014/4, Kluwer Law International BV, The Netherlands, p. 192.

[153] Panayi 2016, p. 109.

In the case of the ATAD the consequence is the recalculation by the tax authority of the tax due by the taxpayer. It is not difficult to conclude that the PPT rule involves a much more severe consequence than the ATAD GAAR.

5.3 Effectiveness of the MLI/OECD Model GAAR

Having presented the scope of both sets of rules and determined the similarities and differences that each present, the effectiveness of the MLI/OECD GAAR is evaluated in this sub-section. Moreover, a comparison with the effectiveness of the ATAD GAAR is made to enable a complete comprehension.

When analyzing the effectiveness of a legal norm two facts must be taken into consideration: a) that the norm is applied by legal organizations (particularly courts), which means that the sanction in a concrete case is ordered and executed; and b) that this norm is obeyed by the individuals that are under a specific legal order. This means that they tend to behave in a manner that avoids the application of a sanction[154].

Following the concept of effectiveness developed by Kelsen we determine that the PPT rule effectiveness could be diminished by various factors, especially its wording flaws. It seems that the intention of the legislator (in this case the OECD) is to give powerful tools to tax authorities all around the world to combat abusive tax practices. However, that disproportionate position of the rule in favour of tax authorities could limit its effectiveness and therefore have the contrary effect to that which was originally desired. In principle, taxpayers and tax advisors would position themselves with a great deal of caution with regards to this rule, especially considering the serious consequences of its application, the loss of all benefits conferred by a tax treaty.

In contrast, it could be argued that the rule infringes basic principles recognized in all legal systems, such as the legal certainty principle, proportionality, amongst others. The flaws of the rule might promote challenges to the extent of the application of it before the competent courts. For instance, countries in the European juridical systems might rely on the jurisprudence of the EUCJ to defend themselves from the broad scope contained in the MLI/OECD Model GAAR knowing that there is great likelihood that the courts would limit the excesses contained in the PPT. At the same time, given the fact that the rule is going to be applied by courts in different

[154] Kelsen 1934, 'Pure Theory of Law' University of California Press and Los Angles Press, 2nd edition, p. 11.

jurisdictions this could imply an uneven application that would result in comparable situations being treated differently. These disparities in the application of the rule by courts could generate serious difficulties in the future. Especially, taking into account the complex process of amendment of a norm contained in a multilateral agreement which would require a lengthy negotiation and ratification process to enact possible changes.

On the contrary, the ATAD GAAR has been developed taking into account most of the principles contained in EUCJ case law which at the same time provides guidance in its interpretation and application either for taxpayers, tax administrations and courts. The EUCJ acts as a unifying jurisdiction in the interpretation of the EU Law which limits the existence of comparable situations being treated differently by courts. The ATAD GAAR has taken the inverse manner for which new rules usually follow. Typically, rules are enacted by the legislator and its consistency with the legal system is tested before competent courts as a result of which we can affirm that its effectiveness is assured beforehand.

Another aspect to be considered with regard to the MLI/OECD GAAR relates to the enforcement of the anti-abuse provision by tax authorities once incorporated into their treaty network through the multilateral agreement. In effect, the GAAR is a minimum standard to be included in contracting states' treaty network, but the application by the countries is not regulated. Unlike rules that distribute taxation rights between countries if one of the contracting states fail to enforce the provisions contained in the anti-abuse rule that does not necessarily imply a breach of the international obligations assumed by that state. There is no direct obligation either on the norm or the commentary that oblige the contracting state to the application.

It seems that the enforcement of the rule is entirely at the discretion of the tax authorities of each member state with regard to the protection of its taxable base. There are different reasons why the anti-abuse provision could be not enforced by tax administrations: lack of know-how in dealing with complex tax planning, different appreciation of the concept of tax avoidance and lack of political willingness.

It is possible to make a distinction between SAARs and GAARs in regard of its deterrent effect. Both are included in tax treaties with the underlying objective of preventing taxpayers from obtaining undue tax advantages. SAARs clearly indicate to the interpreter the situations in which the rule would applied. It is possible to say that the SAARs have an autonomous deterrent effect because its scope is clearly ascertainable for anyone that can interpret the regulation. Conversely, GAARs require direct participation from tax authorities in order to

enforce them. It is not sufficient that the rules are in the treaty in order to obtain the required result. It would require deliberate application in specific situations. It requires a specific audit by tax authorities in specific situations.

Consequently, the sole inclusion of the MLI/OECD Model GAAR in the treaty network of a country does not create *per se* the deterrent effect pretended. Taxpayers when entering into an arrangement are going to consider - firstly the probability of the application of the rule by contracting states – expertise, domestic developments of the concept of abuse of law and political willingness – and, secondly the chances of obtaining a favorable judgement of a competent court due to the flaws contained in the wording of the rule.

Notwithstanding the foregoing the introduction of the GAAR in the MLI might have a positive result in a jurisdiction in which domestic courts have ruled out the possibility of an application of domestic anti-avoidance rules in the international tax treaty context. In those contexts, the PPT rule inserted through the MLI to the treaty network would allow tax authorities to apply the GAAR in situations in which it was prevented from doing so by force of domestic law and interpretation.

Similarly, as expressed in this sub-chapter the author Bergedahl has expressed the idea that the efficacy of the PPT rule is yet to be seen – after the ratification of all contracting states – and will depend on the willingness of states to use the rule, and the response of judiciaries to its construction. The parameters of the PPT rule will become clearer once the judicial organs of various states have had their say on the matter. The author foresees the possibility that the PPT rule will follow the same path as the concept of 'beneficial ownership' that resulted in divergent interpretations in courts around the world[155].

5.4 Conclusions

In this section two elements have been addressed in relation to the thesis subject; a comparison between the two GAAR designs; and the possible outcome regarding the effectiveness of the PPT rule. From the first sub-section it is concluded that the MLI/OECD GAAR presents various elements that differ substantially from the GAARs at EU level that could be found incompatible with the system already in place at EU level. The GAAR introduced by the OECD has a wording that might affect legal certainty by giving it broad powers of definition regarding

[155] Bergedahl 2018, 'Anti-Abuse Measures in Tax Treaties Following the OECD Multilateral Instrument – Part 2', Bulletin for International Taxation February 2018, IBFD, p. 85.

schemes to tax authorities. It lacks the artificial requirement element, it does not consider the existence of substantial economic reasons to override the appellation of the rule, it places an uneven burden of proof between taxpayer and tax authorities and is incompatible in relation to the objective element.

The second element addressed in this section was the effectiveness of the rule, which in time presents two elements. The effectiveness regarding the enforcement of the rule by tax authorities, and the application of the rule by domestic courts around the world. In this respect the conclusion is that there is still too much time before the rule is tested by local courts. Its inclusion in the treaty network is still in the process of ratification in various contracting states that have signed the multilateral agreement. Once in force, the enforcement of the rule requires the deliberate decision of the tax authorities of the contracting states to implement its application. There is no obligation arising from the rule that contracting states must enforce it, therefore it is yet to be seen the practical relevance in countries that decide to continue in the tax competition path by allowing taxpayers to take advantage of undue treaty benefits.

Once enforced by the tax authorities the following step regarding the effectiveness of the rule is the interpretation of domestic courts around the world. It is most likely that the rule would be applied in divergent ways, taking as a precedent the application of the concept of 'beneficial ownership'. The way in which the rule is adopted in each juridical system is yet to be seen. However, it has features that would encourage taxpayers to challenge it application. In particular, the principle of legal certainty and predictability of the rules that have negative consequences.

To sum up, the practical use of the PPT rule would be determined in a long-term process. It might produce an immediate result with taxpayers: in that they would plan its business structures much more carefully taking into consideration the existence of this rule in the applicable treaties. However, different factors could diminish the deterrent effect of the rule in the long-term run on a global level. This are, among others, a) contracting states are not obliged to enforce the PPT rule contained in the MLI. It was only required to adopt the rule in their tax systems. Tax competition could prevent tax authorities to apply the rule to abusive practices *(Laissez faire).* There is also the possibility that tax planners take advantage of jurisdictions that lack the technical expertise or resources to enforce the rule; b) many possible outcomes in the interpretation of the rule by competent courts of all contracting states.

Section VI – Final Conclusions

In this final section the answer to the main research question is presented by the author. The primary research question is to determine to what extent the PPT rule contained in Article 29 of the OECD Model, and Article 7 of the Multilateral Agreement (MLI) are effective in order to minimize the use of aggressive tax planning. In order to address this issue, this study is divided into three sections. Sections III and IV respectively address the PPT rule and the ATAD GAAR, which is taken as a benchmark for the analysis. Those sections are based principally on the review of literature outlining different perspectives in the study including the scope, elements, composition and consequence of the application of each rule. Section V presents the analysis and evaluation of the PPT rule and directly addresses the effectiveness of the rule and possible outcomes of its application.

As concluded in Section V the effectiveness of the PPT rule to tackle tax abusive practices would depend very much on the way that it is applied by different courts around the world. However, one could foresee that some elements of it would diminish its effectiveness. Those elements refer to the subjective assessment of abuse, and the fact that its application is discretional for tax authorities. The subjective element would give rise to many conflicts between taxpayers and tax authorities and would produce a disparity in the interpretation of the rule amongst contracting states based on their different approach towards the concept of abuse.

It is the author's opinion that fundamental changes in the system of international tax treaties should be made by the OECD to tackle abusive tax planning. Coordination is not enough if it produces stop-gap measures that in the end will generate problems of interpretation, disparities, create judicial conflicts, do not provide legal certainty for taxpayers and that could end up generating different treatment for similar situations. Aggressive tax planners and advisers would still find their way into this system, even with general anti-abuse rules providing powerful weapons to combat these practices. Ironically, it is more likely that *bona fide* situations would end up covered by anti-abusive rules rather than really abusive schemes.

It is important to remember that the aim of double tax conventions is not avoiding double taxation or avoiding double non-taxation instead it is the promotion of free flow of goods and services by allocating tax jurisdictions. Consequently, an origin-based taxation would be much more aligned to those objectives. It would be much more effective in combating abusive tax practices because it looks at the reality of the economic production avoiding the rather formal approach that gives rise to aggressive tax planning and manipulation of the system.

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