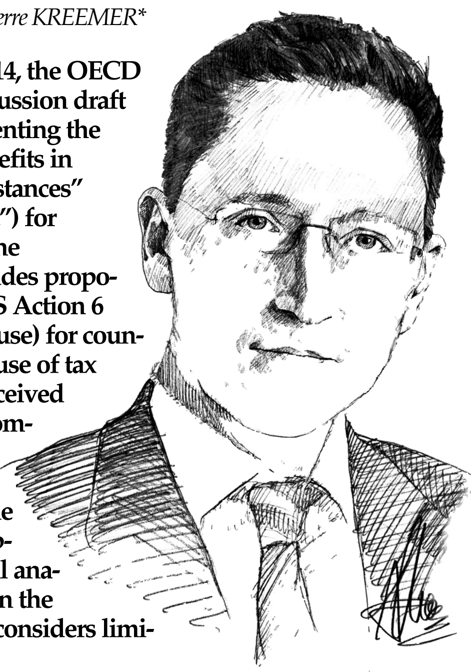
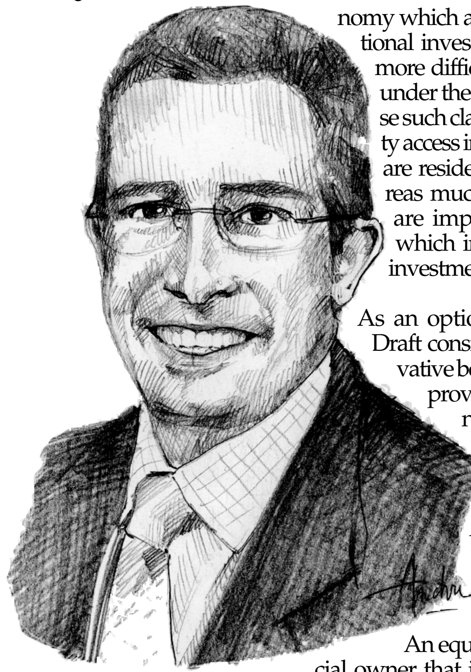
The OECD Discussion Draft on BEPS Action 6 (Prevent treaty abuse): A critical analysis

*By Oliver R. HOOR and Pierre KREEMER**

On 14 March 2014, the OECD released a discussion draft entitled "Preventing the granting of Treaty Benefits in Inappropriate Circumstances" (the "Discussion Draft") for public consultation. The Discussion Draft includes proposals in relation to BEPS Action 6 (Preventing Treaty Abuse) for counteracting perceived abuse of tax treaties. The OECD received more than 60 public comments in response to the Discussion Draft. This article explains the problem of treaty shopping, provides a critical analysis of the proposals in the Discussion Draft and considers limitations set by EU law.





I. Introduction

Bilateral tax treaties are an important and well established feature of the international tax system. Their main purpose is the promotion of cross-border trade through the allocation of taxing rights between two Contracting States and the determination of mechanisms for the elimination of double taxation. Today there are more than 3,000 tax treaties in force around the globe. Though every tax treaty is subject to negotiations between the two Contracting States, the majority of tax treaties are fairly similar. This is because the treaty negotiations between the Contracting States are generally based on the OECD Model Tax Convention ("OECD-MC") and are then tailored to the particular economic interest of each Contracting State. [1]

On 19 July 2013, the OECD published its Action Plan on Base Erosion and Profit Shifting ("BEPS") that provides for 15 actions. The BEPS Action Plan identifies treaty abuse and in particular treaty shopping as one of the most important sources for BEPS concerns. Action 6 of the BEPS Action Plan (Preventing Treaty Abuse) aims at the following three areas:

1. Development of model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances.
2. Clarification that tax treaties are not intended to be used to generate double non-taxation.
3. Identification of the tax policy considerations that, in general, countries should consider before deciding to conclude a tax treaty with another country.

The present Discussion Draft proposes various anti-abuse provisions to be inserted into the OECD-MC including a Limitation-on-Benefits ("LOB") provision, a Main Purpose Test ("MPT") and a number of Specific Anti-Abuse Rules ("SAARs").

II. What is treaty shopping and how is it tackled?

Broadly, "Treaty shopping" can be defined as the use of tax treaties by persons who are not themselves within the personal scope of the Convention[2]. Treaty shopping aims at the reduction of withholding tax in the source state through the application of a tax treaty. In general, this may be achieved through the interposition of a conduit company resident in a state which has concluded a beneficial tax treaty with the state in which the income is obtained.[3]

Tackling treaty shopping is not a new topic. The current version of the OECD-MC and the Commentary thereto provide for a number of anti-abuse provisions which may be included in bilateral treaties. While the current version of the OECD-MC does not contain any general anti-abuse rule ("GAAR"), the Commentary to Article 1 OECD-MC[4] provides for several provisions that may be included in tax treaties as a safeguard against conduit companies. These anti-abuse provisions include (i) the "look-through" approach[5], (ii) the "exclusion" approach[6], (iii) the "subject-to-tax" approach[7], (iv) the "channel" approach[8] and (v)"bona fide" provisions[9].

In addition to the provisions to combat conduit companies cited above the Commentary also offers a detailed LOB provision, the purpose of which is to prevent persons who are not resident of either Contracting States from accessing treaty benefits through the use of an entity that would otherwise qualify as a resident of one of these states.[10]

Article 10 (dividends), Article 11 (interest) and Article 12 (royalties) of the OECD-MC further provide for the beneficial ownership concept. This is an anti-abuse rule designed to avoid treaty shopping by agents, nominees or conduit companies for the benefit of a resident of a third state.

Where dividends, interest or royalties deriving from a Contracting State are paid to a resident of the other Contracting State, the taxing right of the source state is in general restricted to a certain percentage of the gross amount[11] or even excluded (in case of royalties[12]). The restriction of the source state's taxing right is contingent on the recipient being the "beneficial owner" of the income under consideration.[13] Where it cannot be evidenced that the recipient of the income is the beneficial owner the source state may tax the income without restrictions.[14]

In addition to the provisions included in bilateral tax treaties, many countries have implemented anti-treaty shopping rules in their domestic tax law in order to avoid the application of tax treaties when the direct recipient of a specific item of income has no substance or is not considered as the beneficial owner of such income. Hence, the granting of treaty benefits in inappropriate circumstances may already be effectively tackled with a number of anti-abuse provisions included in tax treaties and under the domestic tax law of the Contracting States.

III. Critical review of the Discussion Draft

1. Opening comments

The Discussion Draft recommends a three-pronged approach to address situations of treaty shopping:

a) Clarify in the title and the preamble of tax treaties that tax treaties are not intended to generate double non-taxation and that the Contracting States intend to prevent tax evasion and avoidance.
b) Include in tax treaties a LOB provision based on the one found in the 2006 U.S. Model Income Tax Convention.
c) Include a MPT and GAAR in tax treaties.

The Discussion Draft further proposes SAARs and notes that a number of other, additional treaty abuse provisions are being dealt with through other BEPS actions.

2. LOB provision

The LOB provision proposed in the Discussion Draft is almost identical to the LOB provision in the 2006 U.S. Model Income Tax Convention and contains both ownership and activity elements. The proposed LOB provision is very complex, entails a number of terms and concepts which are not particularly clear and denies treaty benefits by default. In other words, treaty benefits would only be applicable where a resident of a Contracting State is classified as a "qualified person" within the meaning of the LOB provision. This would reverse the general principle that companies should be able to enjoy the benefits of tax treaties concluded by their state of residence to the extent they perform "genuine economic activities".

The proposed LOB provision contains several tests which can be overly restrictive in their application and may often result in a denial of treaty benefits although there may not exist a treaty shopping concern. Accordingly, the proposed LOB provision is clearly not limited to abusive situations. Therefore, it is not surprising that many commentators assert that the LOB provision needs significant amendments in order to be exclusively targeted at clear cases of abuse.

The proposed LOB provision would exclude most holding companies from treaty benefits. In this regard, many commentators explicitly state that holding, financing, licensing and investment activities are legitimate business activities and that the LOB provision should take into account the substance and purpose of a company performing such activities.

From a political perspective, it is evident that the mechanism of the LOB provision is inherently biased in favour of larger jurisdictions. In contrast, for companies resident in jurisdictions with a small economy which are more reliant on an international investor base, it will be unequally more difficult to be a qualifying person under the LOB provision. This is because such clauses automatically grant treaty access in case the majority of investors are resident in the same country whereas much more restrictive conditions are imposed on smaller economies which inevitably depend on foreign investment.

As an optional feature, the Discussion Draft considers the inclusion of a "derivative benefits" provision[15] in the LOB provision under which a company that is a resident of a Contracting State but fails to qualify under the LOB provision (due to its foreign shareholders) may nevertheless be entitled to treaty benefits if the foreign owner is an "equivalent beneficiary."

An equivalent beneficiary is a beneficial owner that is resident in a third country with which the other Contracting State also has a tax treaty. However, for certain items of income, a beneficial owner does not automatically qualify as an equivalent beneficiary simply because its country has a tax treaty with the other Contracting State. For those items of income (including dividends, interest and royalties), the third country's treaty must offer withholding rates "at least as low" as the rate available under the claimed treaty. While there is a consensus between commentators that it is imperative to include such a provision in the LOB provision, many commentators further consider that the "derivative benefits" provision is to narrowly drawn to be of assistance to safeguard treaty benefits for all situations where there is no treaty abuse concern.

A particular issue that has raised the attention of the commentators relates to the investment activities of collective investment vehicles ("CIVs")[16]. Under the proposed LOB provision, the making or managing of investments by a CIV (or a holding company controlled by a CIV) will be deemed as not satisfying the "active trade or business" test under the LOB provision (unless carried on by a bank, insurance company or securities dealer). This stands in stark contrast to the conclusion of a report adopted in 2010 by the OECD Committee on Fiscal Affairs entitled "The granting of treaty benefits with respect to the income of collective investment vehicles".

This Report concludes that it is entirely appropriate that CIVs should be granted treaty benefits (on their own behalf). Many commentators highlight that regulated investment vehicles designed to promote (cross-border) collective investments are good for the financial market and the stability and efficiency of the financial sector. Moreover, there are different kinds of commercial reasons for the structuring of investments via alternative investment funds (for example, real estate and private equity funds) and holding companies held by such funds; treaty shopping is not the purpose of CIVs. In light of the above, it is suggested to include CIVs in the definition of "qualifying person" under the LOB provision provided that certain conditions are met.[17]

3. Main purpose test (MPT)

In addition to the LOB provision, the Discussion Draft contains a MPT. Even if the requirements of the LOB provisions were satisfied, the MPT would deny a treaty benefit where it is reasonable to conclude that obtaining the treaty benefit was "one of the main purposes" (emphasis added) of any arrangement or transaction unless the taxpayer is able to establish that granting the benefit would be "in accordance with the object and purpose" of the relevant treaty provisions. However, are tax considerations not present in each and every genuine business activity? Moreover, should businesses be accused of aggressive tax planning if they respond to legislative tax incentives which have been voluntarily implemented for the purpose of attracting investment?

The contradictory message of the MPT is that treaty benefits are available to qualifying taxpayers unless taxpayers intend to gain from those benefits. In any case, the threshold to deny treaty benefits would be significantly reduced as compared to the existing guidance in the Commentary to the OECD-MC.[18]

While the LOB provision and the MPT are aimed at addressing treaty shopping there are fundamental differences between the two approaches. The LOB provision is technically complex but leaves limited room for subjective and arbitrary assessments. In stark contrast, the MPT opens the door for tax administrations to disqualify taxpayers from treaty benefits where "one of" the main purposes of an arrangement or a transaction is considered to be a given treaty benefit. Obviously, this injects a subjective element into every aspect of determining whether treaty benefits are available and not much guidance is provided with regard to when treaty benefits will be granted. Similarly to the proposed LOB provision, the MPT imposes a significant burden on the taxpayer ("establish that the granting of tax benefit would be in accordance with the object and purpose of provision in the convention"), whereas the onus on the tax administration is set low ("reasonable to conclude", "one of the main purposes", "directly or indirectly").

Nearly all commentators consider the MPT as much too vague, wide scoped and subjective. Such a provision would create significant uncertainty for taxpayers (and their advisors) because of the extremely unpredictable outcomes. Many commentators emphasize that such clause would cause serious concerns for bona fide businesses. In particular, holding, financing, IP management and investment activities are all acceptable and genuine business activities that may fall within the scope of the MPT.

Should a MPT be inserted in the OECD-MC, it should be designed to tackle only wholly artificial arrangements that are set up solely for the purpose of obtaining treaty benefits. Accordingly, it should be established that "the main purpose" instead of "one of" the main purposes was to obtain the tax benefit. The provision should further only be applicable if it is established that granting the benefit would be contrary to the objective of the provisions of the Convention.

4. Title and Preamble

The Discussion Draft proposes that the title to the OECD-MC be replaced with the following wording: "Convention between … and … for the elimination of double taxation with respect to taxes on income and on capital and the prevention of tax evasion and tax avoidance" (emphasis added). Moreover, the proposed preamble states that the parties intend that the Convention eliminates double taxation "without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance". It is interesting to note that the proposed preamble devotes one line to referring to the prevention of double taxation (the main purpose of tax treaties) and three lines to the prevention of abuse of the Convention.

The proposed amendments may call into question unambiguous treaty terms and thereby add an unwarranted level of complexity to treaty analysis and contribute to uncertainty. Here, several commentators stress that a preamble should not be used for rule-making and that the proposed title could be interpreted to undermine the fundamental principle that a tax treaty should only relieve and not increase the taxation imposed under the domestic tax laws of the two Contracting States.

Many commentators reemphasize that the main purpose of a tax treaty is to facilitate cross-border trade and investment through the elimination of double taxation and that the prevention of tax avoidance and evasion (in general) or treaty abuse (in particular) is not the main objective for entering into a tax treaty. While it is necessary to prevent treaty abuse, it is not the purpose of a treaty to prevent its own abuse. It is only natural that countries should in their treaty negotiations aim at designing treaty provisions in a way that does not allow unintended non-taxation. Some commentators further suggest that it should be clarified that although tax treaties are not intended to be used to generate double non-taxation, double non-taxation is sometimes sought by the two Contracting States in order to make foreign investments more attractive.

5. Tie-breaker rule

In the current version of the OECD-MC, Article 4 (3) OECD-MC seeks to settle dual residence of companies. In many jurisdictions, companies are considered to be tax resident if either their seat or their place of effective management is located in that state. Thus, cases of dual residence may occur if only one of both criteria is fulfilled.

In these circumstances, the entity shall be deemed to be a resident of the Contracting State in which its place of effective management is situated (the "corporate residence tie-breaker"). The main purpose of the tie-breaker rule is the determination of the state of residence of a company which is essential for the application of a tax treaty and the avoidance of a concurrent liability to tax the worldwide income in two contracting states.[19] It should be noted that instances of dual residency usually occur for non-tax reasons (for example, companies may want to change their place of effective management while keeping their corporate identity for commercial reasons, for employment reasons, etc.).

The Discussion Draft provides that the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the state of residence (without real guidelines or rules for them to apply). In the absence of such agreement, a dual resident company shall not be entitled to any relief or exemption from tax provided by the relevant tax treaty except to the extent as may be agreed upon by the competent authorities of the Contracting States.

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4ème édition du Luxembourg Green Business Summit

Le jeudi 24 avril s'est tenue la 4e édition du Luxembourg Green Business Summit, rassemblant près de 600 décideurs issus de l'écosystème économique luxembourgeois et de sa Grande Région. Placé sous le thème «Business Growth Turns Hybrid», cet événement unique, en présence de la Ministre Carole Dieschbourg, en charge de l'Environnement, a également récompensé les meilleurs projets et les réalisations Green des acteurs de la place luxembourgeoise, pour des initiatives internes et/ou la mise sur le marché de nouveaux produits et services Green.

Innovation et entreprenariat

L'évolution du Green Business est une nécessité qui n'échappe plus aux professionnels. 74% des CEOs assurent également que mesurer et prévoir leur impact global (social, environnemental, économique et fiscal) assurera la pérennité de leur activité*. Au delà de la prise de conscience environnementale, il y a donc un impératif économique d'aller chercher la croissance liée au green.

Le Luxembourg Green Business Summit est donc devenu un rendez-vous incontournable pour les dirigeants luxembourgeois qui partagent ainsi avec leurs pairs et avec les invités d'honneur internationaux leurs visions, leurs objectifs, et la mise en place de leurs bonnes pratiques. **Laurent Rouach** (cf. portrait), Partner chez PwC a ouvert cette soirée en soulignant le soutien de PwC envers cet événement.

«Nous sommes très attaché à cet événement, car nous avons lancé lors du premier Luxembourg Green Business Summit notre département de développement durable, il y a de ça 4 ans. Depuis, nous sommes toujours heureux de pouvoir contribuer à un tel événement, mais également de voir la part toujours plus grande que prend le développement durable au Luxembourg», a souligné Laurent Rouach avant d'accueillir la ministre. Carole Dieschbourg, en charge de l'Environnement, a déjà une vision claire des opportunités que peuvent être offertes aux entreprises au travers d'une approche responsable et environnementale.

«Le Green Business Summit est devenu un rendez-vous incontournable dans le domaine du développement durable au Luxembourg. Je voudrais féliciter tous les acteurs qui ont contribué à réaliser cet événement et je félicite également toutes les personnes qui sont présentes aujourd'hui, qui comme moi, sont des acteurs qui contribuent au changement de modèle économique au Luxembourg, innovant et compétitif», a expliqué Carole Diescbourg lors de son discours d'ouverture.

«Le Green luxembourgeois est en plein développement et cela me réjouit de voir autant de diversité, de motivation et de dynamisme dans les secteurs d'activités. Il va s'en dire que l'intégration du développement durable au coeur du business est actuellement un des défis les plus importants et surtout une des clés de la réussite. Il faut tenir compte de la limite de nos ressources naturelles et être conscient de devoir être plus efficace au niveau des ressources naturelles, de l'énergie et des coûts. Si nous réalisons cela, nous deviendrons les acteurs d'un monde innovant et durable. De par mon expérience, je reste persuadé que l'on peut réussir sur ce nouveau chemin à condition d'être prêt et surtout avoir l'esprit d'entrepreneuriat. C'est en effet, cet esprit qu'il nous faut avoir au Luxembourg pour changer notre société. Cela passe par des entreprises qui innovent et qui ont cet état d'esprit. La présence ce soir d'autant d'entreprises me conforte pour l'avenir du Green au Luxembourg» ajoute Carole Diescbourg.

Challenges globaux et stratégie Green

Professeur Gerhard Prätorius, Responsable CSR et Développement Durable du Groupe Volkswagen a expliqué l'approche de la marque allemande en terme d'éco-responsabilité. L'industrie développe en effet une stratégie green afin que celle ci soit un moteur de croissance autour de cette démarche. «L'automobile est une des problématiques de la pollution, mais elle peut également être une des solutions», souligne Gerhard Prätorius.

A travers les 12 marques indépendantes du groupe ainsi que l'entité financière de Volkswagen, le groupe représente près de 8 millions de personnes à travers le monde. La stratégie du groupe Volkswagen est donc basée sur une compréhension moderne de la responsabilité des entreprises. Combiner les valeurs traditionnelles de l'activité de l'entreprise avec les défis de notre temps ; autrement dit intégrer la responsabilité et le développement durable au travers d'une perspective globale.

La politique environnementale de Volkswagen repose sur 3 piliers: les produits, la production et les employés. A travers le développement de nouvelles technologies et services de mobilité, les produits du groupe s'appuient sur l'innovation pour répondre aux objectifs fixés. La gestion de l'énergie, des solutions logistiques et IT sont les points fort du management de la chaîne de production.

Enfin, afin de faire face à ces nouveaux défis industriels, Pr. Prätorius a rappelé qu'il est essentiel de garder les employés au coeur de cette évolution. Ainsi le groupe a développé de nombreuses initiatives telles qu'une charte sociale partagée par toutes les entités du groupe où qu'elle soit dans le monde.

Des objectifs clairs et un but précis

Ce sont donc des objectifs clairs qui ont été fixés par la firme allemande: une réduction de 25% d'énergie, d'eau, de déchets, de CO2 et de composés organiques volatiles par véhicule et par composant. Cet objectif permet au groupe de mener une approche CSR intégrée à travers une approche traditionnelle permettant notamment la gestion des dépenses du groupe mais aussi une vision plus moderne cherchant à gérer comment gagner de l'argent. Car cette demande de Green est partagée par toutes les parties prenantes.

Pr. Prätorius a par exemple rappelé que 80% des voitures du groupe sont vendues dans des pays avec une régulation des émissions de CO2 et que ces exigences des états continues d'augmenter. De la même manière, la pression des marchés financiers est un conducteur du développement durable. Il a aussi expliqué que les clients du fleet sont de plus en plus demandeurs de solutions green afin de répondre à leurs propres objectifs et politique de développement durable. Pour répondre à cette demande, Volkswagen a développé un nouveau produit permettant d'offrir aux gestionnaires de flottes, une combinaison de véhicules moins polluants, avec des formations de conducteurs et des solutions permettant d'investir l'argent gagné grâce à ces économies d'énergies dans des projets green communs avec la société.

Une vision du marché

Pour une industrie comme celle de l'automobile, l'innovation est au centre des solutions en cours et à venir. La demande globale du marché pousse les leaders à changer leurs business models. Ainsi, une Golf n'est plus un modèle simple mais existe à travers 5 offres différentes répondants à différents critères. Mais le modèle du business Green n'est pas encore abouti et arrêté.

Les visions et les stratégies sont encore variées et l'intervention de Miriam Kennet, Co-Fondatrice et CEO, du Green Economics Institute a été beaucoup plus centrée sur la vision et la détermination qu'implique le Green. Elle a partagé sa vision d'experte en terme d'économie verte. L'approche de Miriam Kennet a mis en avant les désastres environnementaux qu'engendre le manque d'approche responsable.

Nommé par le Charity One World, comme faisant parti des 100 femmes invisibles les plus puissantes au monde, Miriam Kennet a parcouru le monde et nous fait découvrir des places d'Europe et d'Amérique qu'elle parcourt chaque année avec ses étudiants. A travers ces voyages, ce sont le partage des bonnes pratiques, le soutien aux communautés sur place et les analyses qui sont faites par l'institut qui constituent la valeur de leur approche. Si Miriam Kennet ne cache pas son positionnement très vert, elle est surtout spécialisée dans l'économie verte. Elle a d'ailleurs fondé le premier journal académique sur le sujet. (Green Economics Journal).

La Bank of America a d'ailleurs récemment qualifié «Green Economics» comme étant un des secteurs les plus dynamiques et sain économiquement parlant. A la suite de ces interventions, la Luxembourg Green Business Awards Ceremony a permis de découvrir les lauréats de cette quatrième édition. Plus de 90 dossiers de candidats ont été présentés à travers 15 catégories aux 51 CEO locaux membres du Jury. Les lauréats, à travers leurs dossiers de candidature et leurs interventions ont démontré l'impact des actions engagées tout comme la dynamique et l'engagement de l'ensemble des équipes.

Suite page de gauche

The proposal regarding the amendment of the corporate tie-breaker rule has been criticized by a number of commentators that consider that the proposal would undermine legal certainty and the rule of law by placing the matter within the hands of the competent authorities.

Indeed, the proposal starts from the wrong assumption that the corporate tie-breaker rule aims primarily at preventing abuse and not resolving double taxation. It seems inappropriate to amend an established rule that provides reasonable and predictable results.

IV. Considerations regarding EU Law

The majority of OECD countries (i.e. 21 of 34 countries) are Member States of the EU that have to respect EU law. In this regard, several commentators raised the question as to whether the proposed anti-abuse rules (the LOB provision, the MPT, etc.) are in violation of EU law. Importantly, any recommendation contrary to the principles of EU law may not be followed by EU Member States (with regard to intra-community dealings).

As a rule, both the principle of freedom of contract and European Court of Justice ("ECJ") case law provide that a given structure may only be disregarded if proven to be a "wholly artificially arrangement". Such a purely artificial structure may be present in the case of "letterbox companies".[20] In the Cadbury Schweppes case, the ECJ acknowledged that a taxpayer is free to rely on its EU freedoms for tax planning purposes as long as the underlying contractual arrangements are not "purely artificial".[21]

The right of a member state to protect its tax base against abusive arrangements is secondary. It follows that "tax jurisdiction shopping" is a legitimate activity in an internal market, even if the choice of jurisdiction is solely based on tax considerations. Why should a company have to choose a higher tax jurisdiction? Nevertheless, EU Member States are free to protect their tax bases by way of anti-abuse rules which are exclusively directed at "wholly artificial arrangements".[22]

An abusive situation not only depends on the intention of the taxpayer to obtain tax advantages but requires the existence of certain objective factors.[23] Amongst these objective elements, the ECJ emphasized the importance of the existence of an "actual establishment" in the host state (for example, premises, staff, facilities and equipment) and a "genuine economic activity" performed by the foreign company.[24] The notion of "genuine economic activity" should be understood in a very broad manner and may include the mere exploitation of assets such as participations, receivables and intangibles for the purpose of deriving passive income.

The nature of the activity should not be compromised if such passive income is principally sourced outside the host state of the entity.[25] In particular, no specific ties or connections between the economic activity assigned to the foreign entity and the territory of the host state of that entity can be required by domestic anti-abuse provisions. Therefore, insofar as the internal market is concerned, the mere fact that an intermediary company is "active" in conducting the functions and assets allocated to it (rather than being a mere letterbox company) should suffice to be out of the scope of domestic anti-abuse rules.

The LOB provision, the MPT and some specific anti-avoidance rules proposed in the Discussion Draft may result in a denial of tax treaty benefits and, hence, in a prohibited restriction of the freedom of establishment. Such restrictions can only be justified by the need to prevent tax avoidance where a specific anti-avoidance rule targets "wholly artificial arrangements aimed solely at escaping national tax normally due". Should the rules proposed in the Discussion Draft prove to impose a lower "abuse" threshold than the standard set by the ECJ, and this is very likely the case, serious doubts can be raised on the compatibility of said proposed provisions with EU law.[26]

Conclusion

The current Discussion Draft is an accumulation of anti-abuse rules including a LOB provision, the MPT and a series of specific anti-abuse rules which would come in addition to existing rules such as the beneficial ownership concept. Were the proposal to be generally adopted, it would undoubtedly make treaty application extremely difficult and result in legal uncertainty and double taxation even where genuine business activities are performed.

It does not seem to be a proportionate response to insert two very different provisions (i.e. the LOB provision and the MPT) that both aim at addressing the same issue. As currently drafted, both the proposed LOB provision and the MPT would be contrary to the purpose of tax treaties and undermine their effect as a tool to facilitate enhanced cross-border trade and investment.

The primary route to tackling the granting of treaty benefits in perceived inappropriate situations should be through specific and targeted anti-abuse provisions included in tax treaties and domestic tax law. Tax treaties should, however, remain focused on removing double taxation and promoting international trade and investment.

The value of tax treaties will be significantly reduced if their applicability is less certain. Many commentators state that maximum one – either a re-drafted LOB provision or a re-drafted MPT – should be included in the OECD-MC provided that such provision is well constructed and appropriately targeted against "artificial" structures. An anti-abuse provision that has the effect of precluding treaty benefits with respect to common business structures where no treaty shopping abuse is present, would do more harm than good and should not be included in the OECD-MC.

It is interesting to note that the LOB provision would place considerable constraints on the location of ownership of companies attempting to benefit from tax treaty provisions. Therefore, the proposed provision would be especially detrimental to smaller States with open economies such as Luxembourg, the Netherlands or Ireland. A resident company with predominantly non-resident shareholders that receives income from a third state (for example, a holding and financing company) would be confronted with a disproportionate burden of proof to obtain treaty protection or will face double taxation. The authors believe that significant changes need to be made to the proposals in the Discussion Draft in order to strike an appropriate balance between preventing the abuse of tax treaties and allowing legitimate treaty benefits to be obtained without undue difficulty or uncertainty as far as genuine business activities are concerned.

In this regard, it should be clarified that holding, financing, licensing and investment activities are legitimate business activities. Furthermore, the Discussion Draft should in line with the recent OECD position reflect that CIVs (and holding companies held by CIVs) may in principle benefit from treaty protection. It is evident that the Discussion Draft as it stands would act as a disincentive to international trade and investment in a manner that undermines the very purpose of tax treaties.

** Oliver R. HOOR is a Senior Manager (Expert Comptable and Steuerberater) and Pierre KREEMER is a Tax Partner (Head of Real Estate & Infrastructure) with KPMG Luxembourg.*

The authors may be contacted at:
oliver.hoor@kpmg.lu
pierre.kreemer@kpmg.lu

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1) See Oliver R. Hoor, "The OECD Model Tax Convention – A comprehensive technical analysis", Legitech, Edition 2010, p. 17.
2) See Oliver R. Hoor, "The OECD Model Tax Convention – A comprehensive technical analysis", Legitech, Edition 2010, p. 72.
3) In case of treaty shopping, the application of the Convention that restricts the taxing right of the source state to a minimum is sought.
4) See Article 1 Paragraphs 7 – 26.2 of the Commentary on the OECD-MC.
5) The inclusion of provisions that exclude from treaty benefits any company which is owned by shareholders that are resident in a third state.
6) The inclusion of provisions which exclude certain privileged types of company (that are tax exempt or nearly tax-exempt) from treaty benefits.
7) The inclusion of provisions which limit treaty benefits in the source state to income which is subject to tax in the residence state.
8) The inclusion of provisions which exclude from treaty benefits any company which is used merely as a channel for payment of the income to a resident of a third state.
9) The inclusion of provisions which limit treaty benefits to companies set up for bona fide purposes and not set up to take advantage of treaty benefits "Bona fide" provisions may take various forms.
10) See Article 1 Paragraph 20 of the Commentary on the OECD Model Convention.
11) Articles 10 (2) and 11 (2) OECD-MC.
12) Article 12 (1) OECD-MC allocates an exclusive taxing right to the residence state of the recipient.
13) The source state will only be obliged to limit its taxation in accordance with Articles 10 (2), 11 (2) and 12 (1) OECD-MC if the beneficial owner of the dividends, interest or royalties is a person who resides in the other Contracting State.
14) See Oliver R. Hoor, "OECD releases discussion draft on the meaning of "beneficial owner" in the OECD Model Tax Convention", AGEFI, June 2011, p. 28; see Oliver R. Hoor, "OECD releases revised discussion draft on the meaning of "beneficial owner" in the OECD Model Tax Convention", AGEFI, November 2012, p. 10.
15) Paragraph 13 of the Discussion Draft.
16) CIVs may be defined as collective investment vehicles which are widely held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established.
17) For example, that the CIV is not controlled by one or few investors and is subject to regulation such as the AIFMD in an EU context. Furthermore, holding companies controlled by such a CIV should be treated as satisfying the LOB test.
18) The proposed MPT in the Discussion Draft differs significantly from the language in Paragraph 9.5. of the Commentary on the OECD Model Tax Convention.
19) See Oliver R. Hoor, "The OECD Model Tax Convention – A comprehensive technical analysis", Legitech, Edition 2010, pp. 33, 65.
20) In the Cadbury Schweppes case (ECJ, 12 September 2006, Case C-196/04, Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue ("Cadbury Schweppes"), http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62004CJ0196:EN:PDF); see Dr. Eric Robert, Driss Tof, "The Substance Requirement and the Future of Domestic Anti-Abuse Rules within the Internal Market", European Taxation, IBFD, November 2011, p. 437; see Oliver R. Hoor, Georges Bock "Luxembourg in International Tax Planning: The importance of Substance and Arm's Length Conditions", Tax Notes International, p. 491.
21) See "Cadbury Schweppes", note 24, Para. 36, 37, 55.
22) See "Cadbury Schweppes", note 3, Para. 51; see Dr. Eric Robert, Driss Tof, „The Substance Requirement and the Future of Domestic Anti-Abuse Rules within the Internal Market", European Taxation, IBFD, November 2011, p. 438.
23) See "Cadbury Schweppes", note 3, Para. 55.
24) See "Cadbury Schweppes", note 3, Para. 54.
25) In addition, the mere fact that a structure may help to shift income from a high-tax to a low-tax jurisdiction does not alone suffice to conclude that the structure is "abusive" (even if the structure has innovative features); See Dr. Eric Robert, Driss Tof, "The Substance Requirement and the Future of Domestic Anti-Abuse Rules within the Internal Market", European Taxation, IBFD, November 2011, p. 438.
26) For example, a LOB provision without a derivative benefits clause would breach the fundamental freedom of establishments.