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Tax Treaty Entitlement

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Tax Law and Policy Series

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Tax Treaty Entitlement

Why this book?
The entitlement to tax treaty benefits is of pivotal importance for taxpayers in order to obtain treaty benefits. However, the application and interpretation of the respective tax treaty provisions are not always straightforward and may often raise various questions. This is all the more true now that the OECD has introduced a number of new provisions regarding the entitlement to tax treaties into its Model Convention as part of the BEPS Project.

This book analyses several crucial areas concerning the entitlement to tax treaties.
The topics covered include:
- The application of the principal purpose test, limitation on benefits clauses and the beneficial ownership test
- The relevance of the term "person" within the OECD Model
- Dual residence for individuals and non-individuals
- The tax treaty entitlement of hybrid entities
- The entitlement to protection against discriminatory taxation
- The personal scope of the mutual agreement procedure and arbitration provisions, and the mutual assistance provisions

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Preface

The entitlement to tax treaty benefits is a topic that has been the subject of intense discussion and it has taken a prominent place in the OECD BEPS Project. As a result of the BEPS Project, the OECD has introduced a number of different provisions concerning treaty entitlement into its Model Convention on Income and on Capital. Some of these provisions will find their way not only into future tax treaties but also into existing tax treaties via the OECD's Multilateral Instrument. However, since many of these provisions have been formulated either vaguely or in extremely complex terms, they raise various questions regarding their interpretation and application.

In order to analyse important issues concerning the entitlement to tax treaty benefits, the 25th Viennese Symposium on International Tax Law was held on 22 June 2018 at WU (Vienna University of Economics and Business). Renowned professors from Austrian and foreign universities, tax researchers from the WU and tax experts from various countries participated in the symposium. The speakers presented their findings in the presence of Sophie Chatel, Head of the Tax Treaty Unit in the OECD Centre for Tax Policy and Administration. They have since completed papers using input received during the symposium, and these papers have become the chapters of this book. Each author offers an in-depth analysis along with the most recent scientific research on their topic.

The editors would like to thank Renée Pestuka and Florian Navisotschnigg who were the main persons responsible for the organization of the symposium and made essential contributions to the preparation and publication of this book. The editors would also like to thank all the authors who have patiently revised their contributions in order to enhance the quality of the book, and Eleanor Campbell, who contributed greatly with her linguistic editing of the authors' texts.

Above all, sincere thanks to the publishing house IBFD, for agreeing to include this publication in its catalogue.

Michael Lang
Pasquale Pistone
Alexander Rust
Josef Schuch
Claus Staringer
Vienna, October 2018

Sample Content

Chapter 2

The Application of the Principal Purpose Test under Tax Treaties

Svitlana Buriak[1]

2.1. The background and design of the principal purpose test

2.1.1. PPT and recent OECD/G20 and OECD developments

The extensive OECD/G20 Base Erosion and Profit Shifting Project (BEPS)[2] in its Final Report on Action 6 "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances"[3] (Action 6 Final Report) focused on tax treaty abuse as one of the biggest concerns of the BEPS initiative. Action 6 intended to provide effective anti-avoidance principles and rules to prevent entitlement of taxpayers to tax treaty benefits in inappropriate circumstances.

With this purpose, the report established the principal purpose test (PPT) as a general anti-abuse rule to counter the abusive transactions aimed at gaining inappropriate tax benefits. The report pointed out that the rule has the ability to prevent some situations where the person circumvents limitations provided by the tax treaty itself.[4] At the same time, the report emphasized that the rule had both strengths and weaknesses and that it was incompatible with the domestic legislation of some jurisdictions.[5] Nevertheless, the BEPS Action 6 Final Report recommended that the OECD countries implement the PPT rule in their tax treaties.

Some years after the publication of the BEPS Final Reports, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base

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1. The author would like to thank Prof. Lang for his valuable input and feedback on this article.
2. OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD 2013), International Organizations' Documentation IBFD.
3. OECD/G20, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Action 6: 2015 Final Report* (OECD 2015), International Organizations' Documentation IBFD [hereinafter *Action 6 Final Report* (2015)].
4. Id., at paras. 5-6.
5. Id., Executive summary, at p. 10.

Erosion and Profit Shifting (MLI)[6] incorporated the PPT rule[7] as a default general anti-abuse provision. The PPT rule became one of the de minimis rules[8] under the MLI. At the same time, the MLI left the right for the signatory countries to opt for application of either the PPT provision, or the detailed limitation on benefits (LOB) provision (specific anti-abuse rule), or a combination of the PPT and the simplified LOB provisions. The majority of the signatory countries have opted for the application of the PPT in their tax treaties, whereas only some jurisdictions have maintained the combination of the PPT and simplified LOB clauses.[9] Accordingly, the PPT, as incorporated in the MLI, might be implemented in more than one thousand treaties around the world, if those countries ratify the MLI.

In November 2017, the PPT rule was also included in article 29(9) of the OECD Model Tax Convention on Income and on Capital (2017) concerning the entitlement to benefits under the Convention.[10] The Commentary on Article 29(9) of the OECD Model Tax Convention on Income and on Capital (2017) was designed on the basis of the findings of the BEPS Action 6 Final Report. Now, the PPT rule can be found in article 29(9) of the OECD Model (2017),[11] article 7(1) of the MLI, and article X(7) of the BEPS Action 6 Final Report. According to these instruments, the PPT reads as follows:

> Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement 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 accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.[12]

It should be noted, however, that the legal relevance of the PPT provision is not the same under all the aforementioned instruments. Article X(7) of the

6. OECD, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (2017), International Organizations' Documentation IBFD [hereinafter MLI].
7. Art. 7 MLI.
8. The de minimis rules are mandatory for all signatories of the MLI and comprise changes in the areas of treaty abuse, mutual agreement procedures and treaty preambles.
9. Those countries include Argentina, Armenia, Bulgaria, Chile, Colombia, India, Indonesia, Jamaica, Kazakhstan, Mexico, Russia, Senegal, Slovakia and Uruguay (as of 8 January 2019).
10. *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017) [hereinafter *OECD Model* (2017)], Models IBFD.
11. Art. 29(9) *OECD Model* (2017).
12. Art. 7(1) MLI, art. 29(9) *OECD Model* (2017).

OECD Model as provided by the BEPS Action 6 Final Report including the Commentary on it is soft law and, hence, not legally binding.[13] Countries are free to implement this provision in their tax treaties if they mutually agree to give it legal force, as well as to derogate from any part of it.

For each signatory country that has ratified, accepted, or approved the MLI and opted for the PPT, the PPT becomes a part of the covered tax treaties from the moment of entry into force of the Convention in their jurisdictions.[14] The wording of the PPT under the MLI was fully transposed from the BEPS Action 6 Final Report. The explanatory statement to article 7(1) of the MLI underlines that the PPT as included in the MLI is based on article X(7) (Entitlement to Benefits) of the OECD Model reproduced in paragraph 26 of the Action 6 Final Report.[15] With respect to interpretation of the provisions of the MLI, the explanatory statement to the MLI emphasizes that they "should be interpreted in accordance with the ordinary principle of treaty interpretation which is that a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose". In addition to this, the Commentary on Article X(7) provided by the Action 6 Final Report has to be used for interpretation of the PPT provision implemented in the tax treaties by means of the MLI.[16]

At the same time, the PPT rule was implemented into article 29(9) of the OECD Model (2017). The OECD Model Commentary (2017) also fully adopted the wording of the Commentary on Article X(7) provided by the BEPS Action 6 Final Report. There are no current differences between the Commentaries on the PPT provision under the Action 6 Final Report and the OECD Model.[17]

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13. OECD/G20 Base Erosion and Profit Shifting Project – 2015 Final Reports: Frequently Asked Questions, Question 4, available at https://www.oecd.org/ctp/beps-frequently-asked-questions.pdf.
14. Art. 34 MLI.
15. OECD, *Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, International Organizations' Documentation IBFD [hereinafter *Explanatory Statement to the MLI*].
16. *Explanatory Statement to MLI*, at para. 12.
17. In case of divergences, it may become relevant for some jurisdictions whether one has to rely on the Commentary provided in the *Action 6 Final Report* (2015) or the *OECD Model Tax Convention on Income and on Capital: Commentary* (21 Nov. 2017), Models IBFD [hereinafter *OECD Model Commentary* (2017)]. The courts of many countries believe that only the Commentaries in force at the time of the conclusion of a treaty (which means the date of the signing of the MLI) or in force at the time of the ratification by the national legislature can be used for the interpretation of the tax treaty (as modified by the MLI). Therefore, the legislature can only accept the interpretation by the OECD, which is available at the time of the ratification of the MLI.

2.1.2. The background to the PPT rule

The concept of the PPT rule is not new; it was developed on the principles already established in paragraphs 9.5, 22, 22.1 and 22.2 of Article 1 of the Commentary on the 2014 OECD Model. In particular, the OECD concludes that the contracting states may deny entitlement to the benefits under tax treaties "when transactions that constitute an abuse of the provisions of these conventions are entered into".[18] The 2014 Model Commentary included what was referred to as the "the main purpose test" or "the guiding principle"[19] to clarify when benefits might be denied. The guiding principle reads as follows:

> A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions… [If] there is a clear evidence that the treaties are being abused.[20]

When comparing the PPT with the guiding principle, one may observe that the "main" purpose subjective test as embedded in the Commentary on article 1 is in contrast to the test of "one of the principal purposes" under the PPT. The "more favourable tax position" wording is missing in the current PPT provision. The burden of proof of abuse for tax authorities seems to be lowered from requiring "clear evidence" to a burden of proof that is "reasonable to conclude". The PPT formulates the objective element of abuse (naming the incompatibility with the object and purpose of the respective provision) rather as an exception to the main part of the PPT, which is not the case in the guiding principle. Therefore, it would be misleading to argue that the provisions of the PPT rule have completely adopted the concepts recommended by the Commentary on Article 1 of the OECD Model (2014).

However, the guiding principle has not been erased from the 2017 Model Commentary. The 2017 update to the OECD Model provides that the guiding principle may apply when a tax treaty does not contain the PPT rule.[21]

18. *OECD Model Tax Convention on Income and on Capital* (26 July 2014), Models IBFD [hereinafter *OECD Model* (2014)] and *OECD Model Tax Convention on Income and on Capital: Commentary on Article 1* para 9.1. (26 July 2014), Models IBFD [hereinafter *OECD Model Commentary* (2014)].
19. The "guiding principle" in this chapter refers to the concepts established in paras. 9.5, 22, 22.1 and 22.2 *OECD Model: Commentary on Article 1* (2014), and in paras. 61 and 80 *OECD Model* (2017).
20. Paras. 9.5 and 22.2 *OECD Model:* Commentary on Article 1 (2014).
21. Paras. 57 and 61 *OECD Model: Commentary on Article 29(9)* (2017).

Additionally, the 2017 Commentary also contains a specific note stating that "[the guiding] principle applies independently from the provisions of paragraph 9 of Article 29, *which merely confirm it*" (emphasis added). The Commentary on Article 29(9) also underlines that "paragraph 9 (the PPT provision) mirrors the guidance in paragraphs 61 and 76 to 80 of the Commentary on Article 1" (i.e. the "guiding principle").[22]

It may be observed that the intent of the OECD was to equalize the effect of the guiding principle and the PPT clause to ensure a unilateral approach to tackling abusive practices by countries regardless of whether their tax treaties contain the PPT or rely only on the guiding principle. However, these concepts contain different criteria for their application and might not lead to the same outcome.

To sum up, the OECD explicitly provides that the PPT was developed on the guiding principle and that it mirrors and *merely confirms* the guiding principle. More specifically, if the PPT provision merely confirms the guiding principle, but does not extend, amend or modify it, the question arises whether the scope of the PPT can be broader than that of the guiding principle. It seems that the answer to such a question must be negative. If this be the case, a restrictive interpretation of the PPT provision may be in order.

2.1.3. The tax avoidance situations at which the PPT is aimed

The OECD distinguishes two sets of circumstances in which a taxpayer attempts to obtain inappropriate tax benefit(s): (i) cases where a person tries to circumvent the limitations provided by a treaty itself, and (ii) cases where a person tries to circumvent the provisions of domestic tax law by using treaty benefits.[23] The PPT rule was designed as a general anti-avoidance rule to prevent the first category of cases from succeeding. In particular, but not exclusively, the PPT is intended to target treaty-shopping situations. At the same time, the PPT is also claimed to be capable of preventing abusive restructuring cases.[24]

22. Para. 169 *OECD Model: Commentary on Article 29(9)* (2017).
23. *Action 6 Final Report* (2015), at para. 15.
24. R.J. Danon, *Treaty Abuse in the Post-BEPS World: Analysis of the Policy Shift and Impact of the Principal Purpose Test for MNE Groups*, 72 Bull. Intl. Taxn. 1, p. 43 (2018), Journals IBFD; *Action 6 Final Report* (2015), at paras. 58-60; paras.180 and 182 *OECD Model: Commentary on Article 29* (2017).

Treaty shopping connotes an effort to receive a tax treaty advantage(s) by entering into an arrangement or transaction by a taxpayer, who otherwise would not be entitled to the benefits under that treaty. Hence, treaty shopping usually refers to circumvention of the treaty provisions defining the personal scope of the treaty.[25] Different forms of treaty shopping can be distinguished, such as e.g. creating direct conduits and "stepping-stone" conduits, to which the PPT clause applies.[26]

Conduit situations refer to abusive practices where a person who is resident of a state whereby he is not entitled to the benefits of a tax treaty establishes an entity in another state in order to obtain those treaty benefits that are not directly available to him.[27] Direct conduit situations refer to schemes involving conduit companies set up in only two jurisdictions, whereas stepping-stone conduits, as a variant of the direct conduit-structure, may involve more jurisdictions.[28]

Abusive restructuring cases additionally include situations where an arrangement or a transaction may lead to the application of a different provision of the same tax treaty which, otherwise, would not be applicable, i.e. rule-shopping structures.[29] "Rule shopping" undermines the application of a rule of a tax treaty, which would not apply in appropriate circumstances.[30]

Moreover, the PPT might also be applicable to abusive situations connected with the tax treatment of dividend transfer transactions and capital gains from alienation of shares or interests of entities deriving their value principally from immovable property covered by articles 8 and 9 of the MLI, respectively.[31]

25. V. Krishna, *Treaty Shopping and the Concept of Beneficial Ownership in Double Tax Treaties*, 19 Can. Current Taxn. 11, p. 129 (2009).
26. *Action 6 Final Report* (2015), at paras. 59-60; para. 182 *OECD Model: Commentary on Article 29* (2017).
27. Danon, *supra* n. 24, at p. 43; L. De Broe, *International Tax Planning and Prevention of Abuse: A Study under Domestic Tax Law, Tax Treaties and EC Law in Relation to Conduit and Base Companies*, IBFD Doctoral Series Vol. 14 (IBFD 2008), Online Books IBFD.
28. Id., at pp. 2-3.
29. Id.
30. Id., at p. 3.
31. Danon, *supra* n. 24, at p. 43; *see also* arts. 8 and 9 MLI.

2.1.4. The design of the principal purpose test

The wording of the PPT rule provides the criteria for its application. These criteria may be divided into two groups: (i) those that set up the elements of abuse (i.e. what situations are seen as abusive in respect of the tax treaty application); (ii) and those that provide the procedural standards for the application of the PPT rule and its legal consequences.

The criteria setting up the concept of abuse under the PPT include the subjective and objective elements. The subjective test of the PPT is the following: the purpose of a transaction or an arrangement to obtain a tax benefit should be a principal purpose or one of the principal purposes of an arrangement or transaction. The objective test may be determined as follows: granting a benefit under the circumstances of an arrangement or transaction would be contrary to the object and purpose of the relevant tax treaty provisions.

The objective aspect of abuse under the PPT may be divided into three elements: the taxpayer's action – "any arrangement or transaction", the result of the action – "benefit under the Covered Tax Agreement", and the character of the result – the benefit has to be contrary to the object and purpose of the relevant tax treaty provisions.

The wording of the PPT distinguishes several procedural steps, which are to be followed by tax authorities to ascertain the objective and subjective elements of abuse, namely:
(1) evaluating all the relevant facts and circumstances of the case (to determine the transaction or arrangement at issue and the benefit under the tax treaty, as well as to determine the link between the action and the benefit);
(2) drawing a *reasonable* conclusion regarding the principal purposes of a transaction or an arrangement;
(3) denying a benefit if one of the principal purposes of a transaction or an arrangement was to obtain that benefit; and
(4) granting that benefit if it is established that it is in accordance with the object and purpose of the relevant tax treaty provisions.

The scope of the application of the PPT application is limited to a respective treaty – a Covered Tax Agreement – between the two contracting states. In line with article 31 of the Vienna Convention,[32] the rule has to be interpreted in the context of the respective tax treaty (including the text of the treaty, its preamble and annexes), as well as in the light of the object and purpose of the treaty and the provision itself. Hence, the application of the elements of the rule in each case has to take into consideration the context, object and purpose of the relevant tax treaty.

For purposes of unilateral determination of the object and purpose of the tax treaties, the MLI[33] provided the preamble text[34] to be included in the tax treaties of signatories to the MLI. Accordingly, the covered tax agreements should incorporate the following preamble:

> Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital *without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance* (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States). (Emphasis added.)[35]

By this amendment, the OECD clarified that the inappropriate circumstances for the application of the tax treaty benefits are treaty abuse by means of tax avoidance and tax evasion.[36] Accordingly, the PPT was developed to clearly address and prevent such circumstances of tax avoidance. Hence, in line with the object and purpose of the tax treaty, the PPT should tackle only abusive structures and deny tax benefits only in abusive circumstances. The following section analyses whether the criteria provided by the PPT are suitable for the purpose of preventing only tax avoidance structures.

32. *Vienna Convention on the Law of Treaties*, art. 31 (23 May 1969), EU Law IBFD. *See also OECD Model: Commentary on Article 29(9)* (2017), which in para. 173 explicitly provides that "paragraph 9 must be read in the context of […] the rest of the Convention, including its preamble".

33. The Preamble of the *OECD Model* (2017) was also updated in respect of the BEPS Project developments.

34. The Introduction *OECD Model: Commentary* (2017) at para. 16.2 also underlines the importance of the preamble for interpretation of the treaty provision, stating that "[s] ince the title and preamble form part of the context of the Convention and constitute a general statement of the object and purpose of the Convention, they should play an important role in the interpretation of the provisions of the Convention".

35. Art. 6 "Purpose of a Covered Tax Agreement" MLI.

36. *Action 6 Final Report* (2015), at paras. 19, 68 and 69.

2.2. The objective and subjective elements of abuse under the PPT

2.2.1. "Any arrangement or transaction"

The Commentary on Article 29(9) of the OECD Model (2017) provides that the wording "any arrangement or transaction" should be interpreted broadly and will include "any agreement, understanding, scheme, transaction or series of transactions, whether or not they are legally enforceable".[37] Furthermore, it is of no consequence for the application of the PPT whether an arrangement or a transaction directly or indirectly resulted in obtaining a disputable benefit for a taxpayer.

A broad approach to the definition of the arrangement or a transaction is important to preclude schemes, including the development of new schemes, created to override otherwise more specific prohibitions embedded in tax treaties. At the same time, the lack of any specific criteria for transactions that should be regarded as abusive may give more discretion to the tax authorities to deny the benefits under tax treaties. Potentially, tax authorities may investigate any arrangement or any transaction as the PPT does not provide any specific additional criteria for identifying arrangements or transactions, e.g. artificiality, lack of economic substance, etc. Accordingly, other elements of the PPT should be examined to identify more specific requirements

2.2.2. "A benefit" under the tax treaty

The concept of benefit is important for establishment of abuse (i.e. the result of the taxpayer's action) and for determination of the consequence of PPT application (i.e. the result of application of a provision).

37. The *Commentary on Article 29(9) of the OECD Model* (2017), at para. 177, states as follows: "In particular they include the creation, assignment, acquisition or transfer of the income itself, or of the property or right in respect of which the income accrues. These terms also encompass arrangements concerning the establishment, acquisition or maintenance of a person who derives the income, including the qualification of that person as a resident of one of the Contracting States, and include steps that persons may take themselves in order to establish residence. […] One transaction alone may result in a benefit, or it may operate in conjunction with a more elaborate series of transactions that together result in the benefit."

As soon as a transaction or arrangement is identified, a tax authority has to decide whether this particular transaction or arrangement leads to obtaining a tax benefit. Moreover, there should be a link (direct or indirect) between the arrangement or transaction undertaken and benefit obtained. It is important to note that the benefit need not actually have been received, but the taxpayer has to have become entitled to it.

The term “benefit” under the PPT rule includes all the entitlements “in respect of an item of income or capital”. In particular, “a benefit” refers to “all limitations (e.g. a tax reduction, exemption, deferral or refund) on taxation imposed on the State of source under Articles 6 through 22 of the Convention, the relief from double taxation provided by Article 23, and the protection afforded to residents and nationals of a Contracting State under Article 24 or any other similar limitations”.[38]

The term “benefit” clearly refers to the securing of more favourable tax treatment by a taxpayer as a result of the application of one or several tax treaty provisions.[39] The examination of a benefit (more favourable tax position) is essential for understanding the subjective intention of a taxpayer. If there is no improvement in the economic tax conditions of a taxpayer, the principal purpose of obtaining a tax benefit is excluded and the PPT should not apply.

The essential issue for application of the rule, though, is how a benefit has to be determined. Apparently, the first step in identifying the presence of a benefit is to find an appropriate comparator for the analysis, i.e. the tax position of the taxpayer should improve compared to comparable treatment. The tax position of a taxpayer may be compared with the position that would be applicable under the domestic tax law or that would be otherwise applicable under other tax treaty provisions.

The first option for comparison is the domestic tax law of the country applying the PPT. The initial object and purpose of tax treaties is the prevention of juridical[40] double taxation in cross-border transactions, which results from the parallel exercise of fiscal rights over the same item of income or capital by two or more jurisdictions, or prevention of economic double

38. *Action 6 Final Report* (2015), at p. 56, at para. 7.
39. *Action 6 Final Report* (2015), at p. 56, at para. 6.
40. Juridical double taxation refers to the situation where a taxpayer is subject to tax on the same income (or capital) in more than one jurisdiction. Economic double taxation refers to the taxation of two different taxpayers with respect to the same income (or capital).

taxation. With this aim, a tax treaty provides benefits, which may be seen as a voluntary renunciation by contracting states of their taxing rights on an item of income or capital or part of it in favour of the other contracting jurisdiction under specific circumstances. Accordingly, the term benefit as generally understood refers to improvement of the tax position of a taxpayer in comparison to that which would be applicable under the domestic law. This option is compatible with treaty-shopping situations, where without a disputable transaction, a taxpayer will not fall within the personal scope of the respective tax treaty and accordingly the provisions of the domestic tax law will be the only provisions that are relevant. However, such an interpretation of the term “benefit” is not that clear as far as rule-shopping arrangements are concerned.

In the case of a rule-shopping arrangement, a benefit under the treaty obtained due to the arrangement or transaction at issue may be compared to a tax treatment under a different treaty provision than would otherwise apply (the second option for a comparator). For example, a taxpayer enters into an arrangement or transaction with the aim of falling within the ambit of article 11 on interest of the OECD Model (2017)rather than article 10 thereof, or to become subject to the dividend rule under article 10(2) rather than the rule under article 10(1).[41] The PPT provision and the Model Commentary (2017) in defining the term “benefit” do not seem to clearly address these situations. The reason for this might be that establishing the tax treatment that would otherwise be applicable requires creating a legal fiction that a transaction has occurred, which has not occurred in reality. Moreover, creating such legal fictions will also require making a choice among several options of circumstances that could have happened without a disputable transaction. Therefore, the issue is how far one can go in creating such a fiction and what would happen if in the future the economic reality (e.g. the ownership of assets) were to have gone in a completely different direction than its legal embodiment.

Nevertheless, there might be two different views on the definitions of “benefit”, which are of particular importance for the result of application of the rule. If one argues that a benefit under the Convention in the PPT has a general meaning as an improvement of tax position in comparison to that under domestic law, then the denial of this benefit has to result in the application of a relevant domestic provision. At the same time, the public discussion

41. M. Lang, *BEPS Action 6: Introducing an Anti-Abuse Rule in Tax Treaties*, 74 Tax Analysts 7, at p. 658 (2014), available at https://www.wu.ac.at/fileadmin/wu/d/i/taxlaw/institute/staff/publications/lang_taxnotesinternational_052014.pdf.

draft[42] expresses the opinion that a "benefit under this Convention" can also exist when such benefit not only arises in comparison to the application of domestic law but also in comparison to another otherwise undisputedly applicable treaty provision. Accordingly, the term "benefit" may also refer to beneficial tax treatment compared to that which would otherwise be applicable. Likewise, the second approach may be more appropriate to provide evidence of whether a taxpayer's arrangement had as principal purpose the circumvention of treaty provisions. However, the first approach is more suitable to establish clearer legal consequences for the application of the PPT.

The second issue is whether the PPT refers to taxation in one of the contracting states, or to the overall consideration of taxes due in the contracting states[43] under a tax treaty or the overall tax burden in all the jurisdictions involved in an arrangement or transaction. The answer is not clearly derived from the PPT clause. For example, if the taxpayer's arrangement aims to trigger a withholding tax reduction under the treaty, this would reduce the tax burden for the taxpayer in the source state but not necessarily the overall tax burden, if the credit method was applied in the residence state.[44] In this scenario, apparently, the taxpayer is not considered to be attempting to obtain a more beneficial tax treatment. However, the source state may still argue that the transaction is abusive as a tax benefit was obtained in that particular state. At the same time, a taxpayer may perform a transaction or an arrangement with the aim not of reducing the overall tax rate applicable to it, but, for example, to be able to use carry-forward losses in one jurisdiction, which are not available in the other. Another example is where the reduction of a withholding tax in the source state allows the parent company in the resident state to increase a possible creditable amount against other foreign taxes. The issue would then be whether these benefits arise from the tax treaty in question, or rather are derived from the tax treaty benefits.

All of these concerns deserve consideration as the definition of the term "benefit" under the PPT is crucial to understanding what the rule attempts to deny in the case of abuse and what the subjective purpose of a transaction or an arrangement should be, which is discussed in more detail in section 2.3.

42. OECD/G20, *BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Public Discussion Draft*, 14 March 2014 – 9 April 2014, available at http://www.oecd.org/ctp/treaties/treaty-abuse-discussion-draft-march-2014.pdf.
43. Lang, *supra* n. 41, at p. 658.
44. Id., at p. 658.

2.2.3. The subjective element: "One of the principal purposes"

The PPT provides that the benefit under the Convention should be denied if "obtaining that benefit was one of the principal purposes of any arrangement or transaction".[45] The criterion of "a principal purpose" expresses the subjective attitude of a taxpayer to a transaction or an arrangement, i.e. the purposes behind an arrangement or a transaction and its desired outcome. The Commentary on Article 29(9) of the OECD Model (2017) emphasizes that "obtaining the benefit under a tax convention need not be the sole or dominant [purpose] … It is sufficient that at least one of the principal purposes was to obtain the benefit".[46]

The subjective element of the PPT faced extensive criticism among interested academics, who expressed concerns about the adequacy of the new approach. De Broe (2008) noted that it is conceptually unacceptable to deny treaty benefits to a taxpayer merely because the obtaining of such benefits is one of the principal motives, if that taxpayer is also able to present important economic motives unrelated to tax treaty advantages.[47] Kok (2016) argues that "the OECD should have chosen for one of the alternative tests, because it is difficult to argue that the taxpayer is abusing a treaty if he has equally important motives to carry out a transaction".[48] Rosenbloom concludes that any dealing that has a "substantial non-tax nexus" should be recognized as legitimate and not be denied treaty benefits.[49]

These stated views are of major relevance as there are no specific clarifications on how the principal purposes of an arrangement or transaction should be defined, how they should be correlated between themselves, or under what circumstances a tax purpose can be referred to as a principal purpose. If a tax authority reasonably assumes that one of the principal motives for an arrangement or transaction was to obtain a tax benefit, and even if a taxpayer succeeds in proving the existence of other principal purposes (disregarding their nature, e.g. commercial or non-commercial reasons), the

45. Art. 7(1) MLI, art. 29(9) *OECD Model* (2017).
46. Para. 181 *OECD Model: Commentary on Article 29* (2017).
47. De Broe, *supra* n. 27.
48. R. Kok, *The Principal Purpose Test in Tax Treaties under BEPS 6*, 44 Intertax 5, pp. 406-412 (2016).
49. H.D. Rosenbloom, *Derivative Benefits: Emerging US Treaty Policy*, 22 Intertax 2, p. 83 (1994), cited in A. Kazacos, *BEPS Action 6: The principle purpose test revisited – Part I*, International Tax Report, available at https://www.internationaltaxreport.com/double-taxation/beps-action-6-the-principle-purpose-test-revisited--part-i--1.htm (accessed 10 June 2018).

PPT rule may still apply. It seems that the PPT does not try to distinguish abusive situations from non-abusive ones for combating tax avoidance and, consequently, it targets all transactions that *potentially* might be but are not always abusive. A taxpayer has no chance to defend himself if it is up to him to prove that benefiting from one or several treaty provisions was not one of his primary motives,[50] and the presence of other motives is not of much help in this case. Will this mean the death of tax planning as arrangements or transactions, in most cases, will have considered the tax consequences?

Considering the developments set out in the BEPS Action 6 Final Report, the PPT was designed as a general anti-abuse rule applicable in situations where "a person tries to circumvent limitations provided by the treaty itself".[51] The interpretation of the provision based on the context in which it was developed may support the position that the subjective test of the PPT has to be narrowly interpreted to address only arrangements and transactions where the purpose is to *circumvent* tax treaties. The circumvention of treaty provisions refers to avoiding the application of the distributive rule in favour of a different article of the Convention (rule shopping) or circumventing the articles that determine access to the treaty by laying down the personal scope (treaty shopping). However, it would be wrong to argue that a taxpayer should be deemed to be circumventing the treaty or domestic law provisions when the object and purpose of the relevant provisions provide alternatives for a taxpayer regarding his behaviour and he chooses the most beneficial option based on tax reasons. At the same time, even in this scenario, the object and purpose of the relevant tax treaties are the determinatives when examining a transaction or arrangement for abusiveness.

The reliance on the ambiguous "one of the principal purposes" criterion as a fundamental element of abuse makes it easy to apply the rule to tackle any transaction. First, the subjective intention of a taxpayer is extremely difficult and sometimes impossible to prove. Second, there are always objective factors, which might indicate that the purpose was driven by tax reasons. In fact, the obtaining of a benefit under a transaction or arrangement already provides grounds for such an assumption. This exercise becomes even easier taking into account the PPT's evidential requirement that it must only be *reasonable* to conclude that an arrangement or transaction is performed for the tax benefits.

50. Lang, *supra* n. 41, at p. 658.
51. *Action 6 Final Report* (2015), at pp. 17-19.

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