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The Anti-Abuse Rule for Permanent Establishments Situated in Third States

A Legal Analysis of Article 29(8) OECD Model

16

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Tax Law and Policy Series

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The Anti-Abuse Rule for Permanent Establishments Situated in Third States

Why this book?
Within the framework of its Base Erosion and Profit Shifting (BEPS) Project, the OECD has developed a new specific anti-abuse rule to address certain types of triangular situations leading to low taxation, resulting in the inclusion of article 10, entitled “Anti-abuse Rule for Permanent Establishments Situated in Third States”, in the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (2016) and article 29(8) of the OECD Model (2017). As a consequence, an increasing number of tax treaties include a specific anti-abuse rule based on article 29(8) of the OECD Model, and since only four OECD member countries have made a reservation to this article, it is expected that this trend will continue.

Despite its growing importance, the provision has received little attention in the tax literature compared to other BEPS measures. This book aims to fill this research gap and provides a critical in-depth legal analysis of article 29(8) of the OECD Model and its functioning within the convention.

The book is of relevance to anyone who deals with the application of article 29(8) of the OECD Model in practice and to anyone interested in the application of tax treaties in triangular cases in general.

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Chapter 1

Introduction to PE Triangular Cases and Article 29(8) of the OECD Model

1.1. Aim and relevance of the research

The topic of this book, namely the anti-abuse rule for permanent establishments (PEs) situated in third states, lies at the intersection of two much debated international tax law issues: (i) triangular cases; and (ii) abuse of tax treaties. Most tax treaties are concluded on a bilateral basis,[1] and issues may arise in situations in which more than two states are involved. Such situations are called triangular situations or triangular cases. Triangular cases can lead to unrelieved double taxation, but they can also be used to generate tax planning structures leading to double non-taxation or an overall low tax burden (low taxation). This book focuses on these latter cases.

Within the framework of its Base Erosion and Profit Shifting (BEPS) Project,[2] the OECD has developed a new specific anti-abuse rule to address certain types of triangular situations leading to low taxation. The provision was developed under BEPS Action 6,[3] and the work on the provision resulted

1. Tax treaties patterned after the OECD Model and the UN Model are concluded by two states. An example of a multilateral tax treaty is the *Convention between the Nordic Countries for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital* (23 Sept. 1996), Treaties & Models IBFD (Denmark, the Faroe Islands, Finland, Iceland, Norway and Sweden).

2. Base erosion and profit shifting refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations (http://www.oecd.org/tax/beps/about/, accessed 31 Dec. 2019). On 12 Feb. 2013, the OECD, supported by the G20, released the report *Addressing Base Erosion and Profit Shifting*, which is generally regarded as the start of the OECD BEPS Project; *see* OECD, *Addressing Base Erosion and Profit Shifting* (OECD 2013), Primary Sources IBFD. This report was followed by the publication, on 19 July 2013, of the BEPS Action Plan, containing 15 actions to be taken to address BEPS; *see* OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD 2013), Primary Sources IBFD. For a general discussion of the development of the BEPS Project, *see*, for example, C. HJI Panayi, *International Tax Law Following the OECD/G20 Base Erosion and Profit Shifting Project*, 70 Bull. Intl. Taxn. 11, pp. 628-659 (2016), Journal Articles & Papers IBFD; C. Schelling, J. Salom & N. Burkhalter, *Overview of the Base Erosion and Profit Shifting Project*, in *Base Erosion and Profit Shifting (BEPS): Impact for European and International Tax Policy* pp. 1-22 (R.J. Danon ed., Schulthess 2016).

3. BEPS Action 6 was one of the 15 action points of the BEPS Project and dealt with preventing the granting of treaty benefits in inappropriate circumstances; *see* OECD/G20,

in the inclusion of article 10 (Anti-abuse Rule for Permanent Establishments Situated in Third States) in the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (2016) (MLI)[4] and article 29(8) of the OECD Model (2017).[5] Article 1(8) of the US Model (2016)[6] and article 29(8) of the UN Model (2017)[7] contain a similar provision. As a consequence, an increasing number of tax treaties include a specific anti-abuse rule based on article 29(8) of the OECD Model,[8] and since only four OECD member countries made a reservation to this article,[9] it is expected that this trend will continue. Despite its growing importance, the provision has received little attention in the tax literature compared to other BEPS measures. This contribution aims to fill this research gap and provide a critical in-depth legal analysis of article 29(8) and its functioning within the OECD Model.

Before turning to the legal analysis of article 29(8) of the OECD Model, the book illustrates how taxpayers use, or used, triangular structures, pursuant to which a resident of a contracting state sets up a PE in a third state to minimize its taxes, and how the tax authorities of some states have facilitated the use of such PE triangular structures to attract foreign investors. Such PE triangular structures are mostly used to reduce taxation on income from licensing, holding and treasury activities, which have become decisive functions of multinationals and generate significant income streams. The overview of the use of PE triangular structures in international tax planning provided in section 2. is based on a literature study. By no means is it intended to be exhaustive. The purpose is only to provide the reader with the necessary background to better understand the reasons why article 29(8) was introduced into the OECD Model, information that is lacking in the

Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Action 6: 2015 Final Report (OECD 2015), Primary Sources IBFD.

4. *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (24 Nov. 2016), Treaties & Models IBFD. The MLI is an outcome of the work of the OECD on BEPS Action 15 on developing a multilateral instrument to modify bilateral tax treaties; *see* OECD, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties – Action 15: 2015 Final Report* (OECD 2015), Primary Sources IBFD.

5. *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017), Treaties & Models IBFD.

6. *US Model Income Tax Convention* (17 Feb. 2016), Treaties & Models IBFD.

7. *UN Model Double Taxation Convention between Developed and Developing Countries* (1 Jan. 2017), Treaties & Models IBFD.

8. A detailed overview of the inclusion of a provision like art. 29(8) *OECD Model* in tax treaties can be found in ch. 3.

9. Belgium, Hungary, Luxembourg and Switzerland.

Commentary on the OECD Model (2017)[10] and the various BEPS Action 6 Reports.[11]

1.2. PE triangular structures in international tax planning

1.2.1. Basic PE triangular structure

One class of triangular cases is PE triangular cases.[12] A PE triangular case exists where a resident of a state (the residence state or State R) has a PE in a third state (the PE state or State P) and that resident of State R receives income originating in another state (the source state or State S) that is attributable to the PE situated in State P. *See* Figure 1.1.

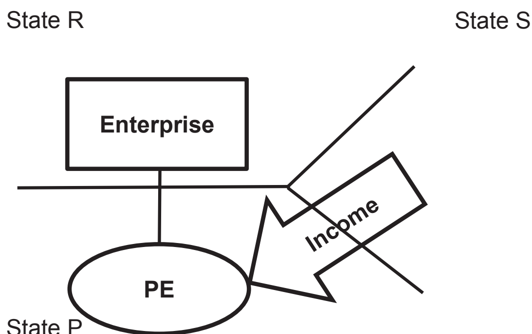
In this example, all three states might have taxing rights, resulting in possible triple taxation. State S might tax the income because it is sourced in State S. State R is likely to tax the income because the enterprise deriving it is a resident of State R. State P would generally claim taxing rights because the income is attributable to a PE situated in that state.

10. *OECD Model Tax Convention on Income and on Capital: Commentary* (21 Nov. 2017), Treaties & Models IBFD.

11. Within the framework of the BEPS Project, the OECD published several reports. Of particular relevance for this contribution are the BEPS Action 6 Reports; *see* OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Action 6: 2014 Deliverable* (OECD 2014), Primary Sources IBFD; and OECD, *supra* n. 3.

12. Other types of triangular cases are dual-resident triangular cases, reverse PE triangular cases and reverse dual-resident triangular cases. For a discussion of the different types of triangular cases, *see*, for example, E. Fett, *Triangular Cases: The Application of Bilateral Income Tax Treaties in Multilateral Situations* (IBFD 2014), Books IBFD; F. Alfredo Garcia Prats, *Triangular Cases and Residence as a Basis for Alleviating International Double Taxation: Rethinking the Subjective Scope of Double Tax Treaties*, 22 Intertax 11, pp. 473-491 (1994); J. Avery Jones & C. Bobbett, *Triangular Tax Treaty Problems: A Summary of the Discussion in Seminar E at the IFA Congress in London*, 53 Bull. Intl. Taxn. 1, pp. 16-20 (1999), Journal Articles & Papers IBFD; G. Zhai, *Triangular Cases Involving Income Attributable to PEs*, 53 Tax Notes Intl. 12, pp. 1105-1124 (2009); S. Yong, *Triangular Treaty Cases: Putting Permanent Establishments in Their Proper Place*, 64 Bull. Intl. Taxn. 3, pp. 152-164 (2010), Journal Articles & Papers IBFD; and K. van Raad & S. Chen, *Triangular Cases – Global Tax Treaty Commentaries*, Global Topics IBFD.

Figure 1.1. Basic PE triangular case



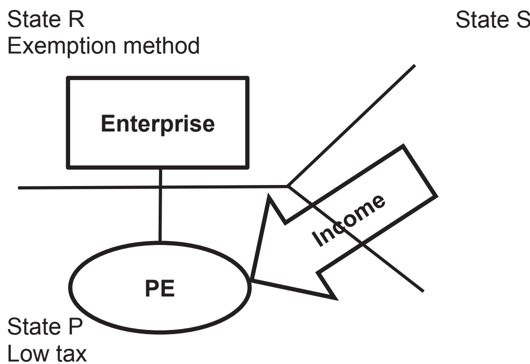
States conclude tax treaties to eliminate juridical double taxation and to promote the exchange of goods and services and the movement of capital, technology and persons.[13] In the event that all three states involved have concluded tax treaties based on the OECD Model, the tax treaty between State R and State S (the R-S tax treaty) and the tax treaty between State R and State P (the P-R tax treaty) will apply. The tax treaty between State S and State P (the P-S tax treaty) will normally not be applicable, because a PE does not qualify as a person under articles 1 and 4 of the OECD Model.[14] The application of the R-S tax treaty and the P-R tax treaty leads to the following result: State S will be bound by the R-S tax treaty, and its taxing rights will depend on the applicable distributive rule. For example, with regard to interest arising in State S and paid to a resident of State R, the taxing rights of State S will be limited to 10% withholding tax (WHT) on the gross amount of the interest insofar as the resident of State R is the beneficial owner of the interest. State P will be bound by the P-R tax treaty. Under article 7 of this tax treaty, it may tax the profits attributable to the PE. Furthermore, the non-discrimination provision included in the P-R tax treaty might oblige State P to grant a credit for the taxes levied in State S.[15] Last, State R is bound by both the R-S tax treaty and the P-R tax treaty and will be obliged to provide relief from double taxation under both.

13. Para.1 *OECD Model: Commentary on Introduction*.
14. OECD, *Triangular Cases* (OECD 1992), Primary Sources IBFD; Fett, *supra* n. 12, at pp. 23-24; K. Vogel, *Klaus Vogel on Double Taxation Conventions: A Commentary to the OECD, UN and US Model Conventions for the Avoidance of Double Taxation on Income and Capital, with Particular Reference to German Treaty Practice* p. 88 (Kluwer Law International 1997).
15. Para. 69 et seq. *OECD Model: Commentary on Article 24*; Fett, *supra* n. 12, at p. 116; A. Rust & V. Wöhrer, *Anti-abuse Clauses for Permanent Establishments Situated in Third Countries*, in *Base Erosion and Profit Shifting (BEPS): The Proposals to Revise the OECD Model Convention* p. 109 (M. Lang et al. eds., Linde 2016).

Depending on the method, State R will either have to exempt the income or grant a credit for taxes paid.[16] The relief provided by State R might be insufficient to prevent double taxation, resulting in unrelieved double taxation.[17]

In contrast, PE triangular cases might also result in low taxation. This will be the case if the taxing rights of State S are limited by the R-S tax treaty, State R exempts the income attributable to the PE pursuant to a provision similar to article 23A of the OECD Model included in the P-R tax treaty or pursuant to its domestic law and State P taxes the income at a low rate or not at all.

Figure 1.2. PE triangular case leading to low taxation



PE triangular tax planning structures leading to low taxation mostly involve dividend, interest or royalty income.[18] In such a scenario, the taxing rights of State S will be limited by articles 10, 11 or 12 of the R-S tax treaty, according to which it can only levy a reduced WHT rate or might be prevented from levying any tax at all.[19] State R exempts the income and consequently does not levy any tax. Furthermore, State P taxes the income at a low rate or not at all, either because it offers a preferential tax regime or because of its territorial tax regime. Consequently, the income will be subject to an overall low tax burden. This outcome creates several tax planning opportunities.

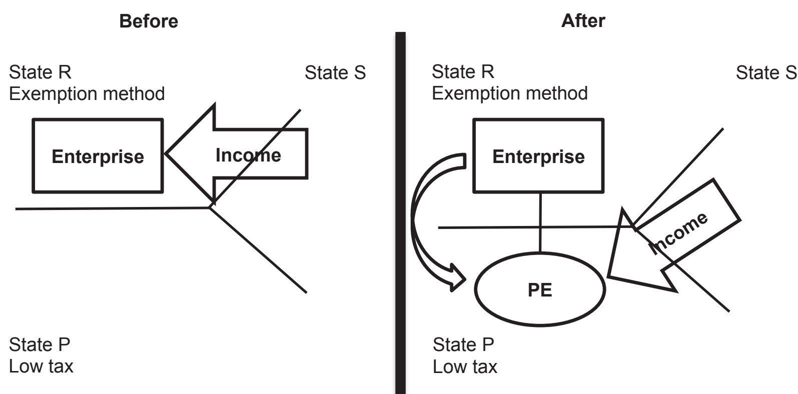
16. Art. 23A or B *OECD Model*.
17. Since the focus of this research is on double non-taxation, the issue of double taxation will not be further discussed. For literature on the issue of unrelieved double taxation in PE triangular cases, *see*, for example, Fett, *supra* n. 12, at p. 67.
18. OECD, *supra* n. 14, at p. 5.
19. For example, according to art. 12 *OECD Model*, the source state is prevented from levying WHT on royalties arising in the source state and beneficially owned by a resident of the residence state. In addition, states can deviate bilaterally in their tax treaties from the WHT rates the source state may levy under arts. 10, 11 and 12 *OECD Model*.

1.2.2. Tax planning schemes

1.2.2.1. Transfer of assets

Rust and Wöhrer (2016) describe two basic types of schemes to achieve a PE triangular case resulting in low taxation.[20] In the first scenario, an enterprise resident in State R, a state that applies the exemption method to provide relief from double taxation, receives income from State S. The enterprise of State R might be able to improve its tax situation by transferring income-generating assets to a (newly established) PE in a third state that offers a lower general income tax rate or offers a favourable tax treatment in respect of certain types of income.

Figure 1.3. PE triangular tax planning scheme – Transfer of assets



The transfer of assets to the PE in State P leads to a loss of taxable income for State R. If State R regards this situation as problematic, it has several options. For example, it could change its policy and apply the credit method instead of the exemption method to provide relief from double taxation, it could challenge the existence of a PE in State P and the attribution of profits to it or it could target the structure through anti-abuse measures, such as controlled foreign company (CFC) legislation.[21] This contribution focuses, however, on the position of State S.

20. Rust & Wöhrer, *supra* n. 15, at p. 110. Variations on these two scenarios are possible, and they can be combined with other tax planning techniques. These variations will not be described herein, because they mostly rely on the same principles as those of the two basic schemes.
21. Id.

The position of State S is different. The transfer of assets to the PE in State R does not have an impact on the taxing rights of State S. The same rules of the R-S tax treaty apply as before the transfer of assets. Nonetheless, State S might regard this situation as problematic. First, State S might have given up (a part of) its taxing rights under the R-S tax treaty assuming that the income would be taxed in State R. It might regard the fact that State R exempts the income, and that little tax or no tax at all is borne, as undesirable. Second, the structure might lead to a competitive disadvantage for residents of State S, because it makes it possible for non-residents of State S to do business in State S without paying significant taxes or any taxes at all.[22]

1.2.2.2. Transfer of residence

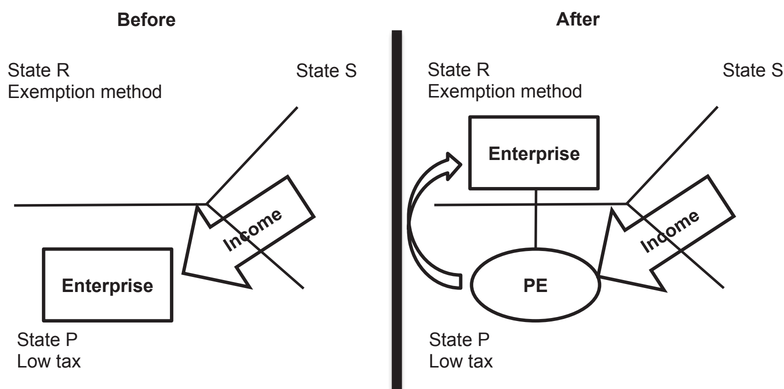
In the second scenario, an enterprise resident in State P receives income from State S. There is no tax treaty in force between State P and State S, or a tax treaty is in force that provides for high source taxation. The enterprise resident in State P might improve its tax position by transferring its residence to a state that has a favourable tax treaty in force with State S, in the example State R, but maintaining a PE in State P to which the income-generating assets are attributable. The income remains attributable to the PE, but, because of the transfer of residence to State R, State S will have to grant treaty benefits under the R-S tax treaty.[23] Consequently, the source state can no longer levy its high source taxation. *See* Figure 1.4.

As a result of the transaction, the taxpayer has a fiscal presence in State R. State R might regard this as positive, because it has attracted additional investment into its state, even though there might be little substance or activity in State R.

22. R. Mason, *US Tax Treaty Policy and the European Court of Justice*, in *Comparative Fiscal Federalism: Comparing the European Court of Justice and the U.S. Supreme Court's tax Jurisprudence* pp. 413-414 (R.S. Avi-Yonah, J.R. Hines & M. Lang eds., Kluwer 2007).

23. It is assumed that the enterprise qualifies as a resident of State R under arts. 1 and 4 R-S tax treaty.

Figure 1.4. PE triangular tax planning scheme – Transfer of residence



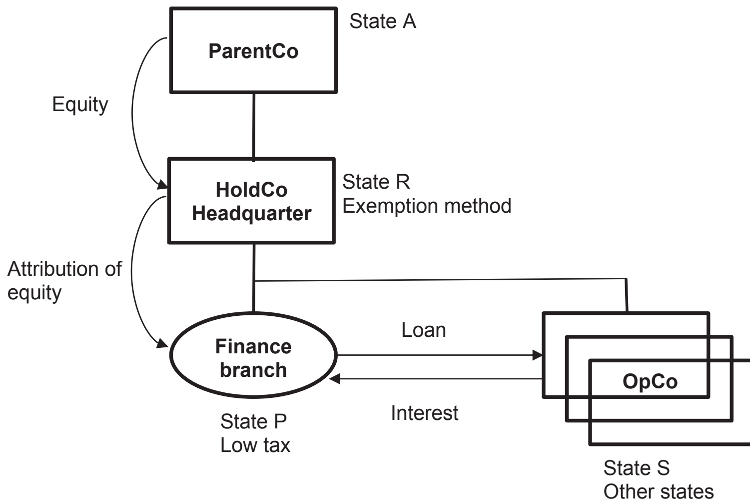
From the perspective of State S, this situation is similar to a classic treaty shopping case, where a person resident in a certain state (State P) who expects to receive dividend, interest or royalty income sourced in another state (State S) sets up an entity in a third state (State R) that will receive the income to benefit from lower taxation compared to a situation in which the income is directly received by the person resident in State P. Thus, similar to a treaty shopping case, in this second scenario, the taxpayer aims to lower source taxation by setting up an entity in a state that has a favourable tax treaty with the source state.

1.2.2.3. Classic planning structure

The use of PE triangular structures as tax planning tools has been described on multiple occasions in the international tax literature, illustrating that the structure is well known in international tax planning.[24] For example, the following classic example of a PE triangular structure regarding interest income is provided in the tax literature:[25]

24. *See*, for example, *Fundamentals of International Tax Planning*, pp. 120-121 (R. Russo ed., IBFD 2007), Books IBFD; P.J. Warner, *Luxembourg in International Tax Planning* pp. 501-510 (IBFD 2004), Books IBFD; X. Oberson & H.R. Hull, *Switzerland in International Tax Law* pp. 72-73 (IBFD 2001), Books IBFD; W. Bush, *Finance Branch Structures*, 34 Eur. Taxn. 3, pp. 92-94 (1994), Journal Articles and Papers IBFD; and S. Widmer & M. Blom, *Reviving the Swiss Branch Concept*, 11 Intl. Tax Rev. 5, pp. 49-51 (2000).
25. R. Offermanns & B. Baldewsing, *Anti-Base-Erosion Measures for Intra-Group Debt Financing*, in *International Tax Structures in the BEPS Era: An Analysis of Anti-abuse*

Figure 1.5. Classic PE triangular tax planning structure: Finance branch



A parent company, situated in State A, holds shares in different operational companies, situated in other states, which, in this example, are collectively referred to as State S, through a holding company situated in State R, a state with a favourable holding company regime. The parent company makes a capital contribution to the holding company, which, in turn, sets up a finance branch in State P, a low-tax jurisdiction, and attributes the capital to the finance branch. The holding company grants loans through the finance branch to the different operational companies.

Assume both State A and the states in which the operational companies are situated apply a corporate income tax rate of 25%. State P, however, has a general corporate income tax rate of 5%, or offers a preferential tax regime in respect of interest income, resulting in a tax rate of 5%. In the event the parent company grants a loan directly to the operational companies, the interest payments from the operational companies to the parent company would, in principle, be tax neutral for the group. The interest deduction at the level of the operational companies leads to an inclusion in the profits of the parent company at the same tax rate (25%). If, however, the parent company decides not to grant the loan directly to the operational companies but to make a capital contribution to the holding company, which, in turn,

Measures pp. 115-17 (M. Cotrut ed., IBFD 2015), Books IBFD; and S. Baumann, *Switzerland: Switzerland's International Position in the Post-IRS Notice 98-35 Tax Hybrid World*, 40 Eur. Taxn. 6, p. 228 (2000), Journal Articles & Papers IBFD.

attributes the capital to the finance branch and subsequently grants a loan through the finance branch to the different operational companies, significant tax savings can be achieved. The interest payments are deductible at the level of the operational companies at 25%.[26] We have seen that, in this situation, the R-S tax treaty applies and that, under this tax treaty, State S can only levy a limited WHT on the interest payments.[27] Furthermore, the income will be exempt in the residence state because of the application of the P-R tax treaty or pursuant to the domestic law of State R. State P taxes the interest income at 5%. This structure thus allows for the tax burden on the income generated by the operational companies to be significantly reduced. Assuming that the tax treaties between the state in which the holding company is established and the states in which the operational companies are established provide for a 0% WHT on interest payments, the tax rate drops from 25% to 5% on the amount of the interest payments.[28]

The example demonstrates that two elements are essential in a PE triangular tax planning structure, namely (i) the location of the headquarters and (ii) the location of the branch.[29] In theory, every state that applies the exemption method to provide relief from double taxation could be a relevant location to set up the headquarters company. Another important element is the availability of a large treaty network providing for low WHT rates on interest, royalty and dividend income. The basic conditions for the location of the branch are that it has a low general income tax rate or that it applies a preferential income tax regime, in particular regarding interest, royalty and/or dividend income.

26. This is the tax rate applicable in the states in which the operational companies are established. The interest deductions lead to a reduction of the tax due in these countries of 25% of the deductible interest amount.
27. Or no WHT at all if the tax treaty deviates from the wording of the *OECD Model* and provides for a 0% WHT on interest payments.
28. This calculation does not take into account the fact that, in respect of the use of a finance branch, a dividend distribution from the holding company to the parent company will normally be necessary to shift the income to the level of the parent company.
29. Furthermore, the example illustrates the possible competitive advantage that this planning structure might generate. A local company in State S that cannot engage in tax planning will be subject to a 25% tax rate on its profits generated in State S. The parent company established in State A, however, can shift some of its profits from State S to State P, lowering the tax rate from 25% to 5% on these profits.

1.2.3. The facilitation of PE triangular structures by some states

1.2.3.1. Relevance

For a better understanding of the workings of PE triangular structures, it is relevant to illustrate how taxpayers have made use of these structures to reduce their tax burden and how some states have facilitated their use by making themselves a favourable location to set up a headquarters or branch in a PE triangular structure. The overview is based on a literature study and is certainly not meant to be exhaustive. Rather, the purpose is to further indicate that the existence of these structures is well known in the international tax planning scene, not only to taxpayers and their advisers, but also to governments, tax authorities and international organizations. Furthermore, it provides an idea of how these structures have worked in practice and which beneficial results taxpayers could obtain. Unfortunately, to the best of the author's knowledge, little data is available on the number of PE triangular structures used in practice and the (tax) amounts involved. The data found, however, indicates that the numbers are likely to be significant.

The use of PE triangular structures in Luxembourg, the Netherlands and Switzerland is referred to herein because these states are most often cited in the literature the author has consulted. Furthermore, the facilitation of these structures by the tax authorities of these states was scrutinized by the Code of Conduct Group initiated by the EU Member States in December 1997[30] and by the European Commission.[31] This certainly does not mean, however, that the tax authorities of other states have not facilitated or tolerated PE triangular structures.[32] Furthermore, the facilitation of these structures by the tax authorities of these countries has to be put into perspective in terms of the time period and context. Because of the decentralized structure of the international tax system, states compete with each other to attract capital,

30. *See* the report of the Code of Conduct Group presented to the Ecofin Council on 29 Nov. 1999, available at https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/primarolo_en.pdf (accessed 31 Dec. 2019). In the report, the Luxembourg finance branch regime (code Z002) and the Netherlands finance branch regime (code B005) were identified as constituting harmful tax regimes.

31. *See*, for example, the press release of the European Commission of 13 Feb. 2007, entitled EU-Switzerland: State aid decision on company tax regimes, available at http://europa.eu/rapid/press-release_IP-07-176_en.htm (accessed 31 Dec. 2019).

32. Among others, the following locations are mentioned in the literature: Austria, Belgium, Cyprus, Hungary, Iceland, Ireland, the Netherlands Antilles, Poland and the United Kingdom.

residents and tax revenues.[33] The facilitation of PE triangular structures in some states was just one way to achieve some of these goals; several other states promoted alternative preferential regimes for the same purpose.[34] A good example is the ruling requested by the Swedish-founded multinational IKEA from the Luxembourg tax authorities.[35] This ruling was revealed by the International Consortium of Investigative Journalists (ICIJ)[36] as a result of the Luxembourg Leaks.[37]

In a nutshell, the part of the ruling request dealing with the implementation of a PE triangular structure can be summarized as follows: At the moment of the request of the tax ruling, the internal banking activities of the IKEA group were managed through a Belgian coordination centre.[38] The Belgian coordination centre regime was a specific tax regime developed to attract foreign multinationals that was introduced in 1982. It provided that the coordination centre would not be subject to the general corporate income tax rate but would be taxed on a notional tax base determined as a percentage of certain operating costs, which was more beneficial for the taxpayer. Coordination centres were used, inter alia, to centralize financial operations.[39] In 2003, the European Commission decided that the Belgian coordination centre regime was incompatible with the EU State aid rules. The Belgian government abolished the regime but provided for a phasing-out period that lasted until the end of 2010.[40] Because the IKEA group would no longer be able to benefit from the coordination centre regime, it decided to restructure its finance activities through the implementation of

33. For an overview, *see* T. Dagan, *International Tax Policy: Between Competition and Cooperation* p. 26 (Cambridge University Press 2018). According to Dagan, "competition has gradually transformed the policymaking process so that states are increasingly operating as recruiters of investments and residents across the globe".

34. *See*, for example, Russo ed., *supra* n. 24, at pp. 107-158. A PE triangular structure is just one tax planning option to structure the finance activities of a multinational enterprise.

35. Ruling Reference EBD/CEEN/ AEVF/Il 909001 M-AEJE from 11 Nov. 2009. The ruling can be found in the database made available by the ICIJ, at https://www.icij.org/investigations/luxembourg-leaks/explore-documents-luxembourg-leaks-database/ (accessed 31 Dec. 2019).

36. The ICIJ is a US-based non-profit organization that works together with a global network of reporters and media organizations who work to investigate the most important stories in the world. *See* https://www.icij.org/about/ (accessed 31 Dec. 2019).

37. Luxembourg Leaks, also called LuxLeaks, is the name of a financial scandal revealed in Nov. 2014 by the ICIJ. The ICIJ made public tax rulings granted by the Luxembourg tax authorities in respect of over 300 hundred multinational companies based in Luxembourg. *See* https://en.wikipedia.org/wiki/Luxembourg_Leaks (accessed 31 Dec. 2019)

38. M.no 13 of ruling EBD/CEEN/ AEVF/Il 909001 M-AEJE from 11 Nov. 2009.

39. M. Quaghebeur, *Belgium Renovates and Generalizes Coordination Center Regime*, 7 Pract. Eur. Tax Strateg. 7, p. 14 (2005).

40. http://europa.eu/rapid/press-release_IP-07-1682_en.htm (accessed 31 Dec. 2019).

a “Swiss finance branch”.[41] A Luxembourg entity of the IKEA group decided to make a cash contribution of EUR 1.2 billion to a branch situated in Geneva. Approximately EUR 6 million would remain with the Luxembourg group entity in order to finance its head-office activities. It was expected that the finance activities of the branch would reach at least EUR 6 billion within a 5-7 year period. The Swiss finance branch would function as the internal bank, and loans would be granted through the branch to other group entities. The Swiss finance branch had, inter alia, the following resources at its disposal: office space in Geneva; employees managing the activities of the branch (with at least a branch manager);[42] office equipment;[43] and a bank account.[44] Consequently, it qualified as a PE under article 5 of the Luxembourg-Switzerland Income and Capital Tax Treaty (1993),[45] and the profits (i.e. the interest income received from the loans to other group entities) attributable to the branch would be exempt in Luxembourg according to article 23(1) of that tax treaty.

Besides providing an example of the use of a PE triangular structure in practice, the ruling illustrates how states compete with each other to attract capital, residents and tax revenues. The abolition of one favourable tax regime, the Belgian coordination centre regime, led to the transfer of the finance activities of the group from Belgium to Luxembourg and Switzerland. Multinationals are mobile, which allows them to compare the tax regimes of different states and select the tax rules and jurisdictions of their choice to organize their business.

1.2.3.2. Netherlands

The Netherlands played an important role in the use, by taxpayers, of PE triangular structures leading to low taxation and the development of a specific anti-abuse rule addressing such structures.[46] In particular, the ruling

41. M.no 13 of ruling EBD/CEEN/ AEVF/Il 909001 M-AEJE from 11 Nov. 2009. For the functioning and favourable tax treatment of a Swiss finance branch, *see* sec. 1.2.3.3.
42. All employees domiciled in Switzerland.
43. For example, desks, cupboards, computers, communication equipment, treasury management systems and accounting systems.
44. Appendix 1 of ruling EBD/CEEN/ AEVF/Il 909001 M-AEJE from 11 Nov. 2009.
45. *Convention between the Swiss Confederation and the Grand Duchy of Luxembourg for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital* (21 Jan. 1993), Treaties & Models IBFD.
46. *See* in detail ch. 3. and the development of the PE triangular provision in the *Convention between the Kingdom of the Netherlands and the United States of America*

practice of the Netherlands, and the granting of PE finance branch rulings by the Netherlands tax authorities, are relevant in this regard.[47]

The Netherlands has a long-standing ruling practice,[48] providing certainty to the taxpayer on the tax treatment in the Netherlands of certain transactions. PE finance branch rulings were one type of ruling that could be obtained from the Netherlands tax authorities. These rulings concerned situations in which a Netherlands company contributes capital to a foreign branch and subsequently grants loans through that branch. In the rulings, the Netherlands tax authorities granted certainty to the taxpayer regarding the interest income that was attributable to the head office in the Netherlands, the amount that was attributable to the PE established in the third jurisdiction and, consequently, what amount would be taxable in the Netherlands and what amount would be exempt. In practice, 80% to 90% of the interest income was allocated to the PE under such rulings, leaving 10% to 20% of the interest income attributable to the Netherlands head office.[49]

In a letter dated 24 December 1986, the State Secretary for Finance of the Netherlands formulated the conditions for granting a PE finance branch ruling:[50]

- the Netherlands company had to be managed from the Netherlands;
- the transactions must not have involved back-to-back loans; and
- real finance activities had to take place at the level of the PE, and the activities had to be conducted by a qualified manager who was not a manager that was active in other non-related entities.

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for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (18 Dec. 1992) (as amended through 2004), Treaties & Models IBFD [hereinafter *Neth.-US Income Tax Treaty*].

47. The possibility of obtaining a ruling is described as critical, because it allows a taxpayer to obtain legal certainty on the outcome of a structure that may be relatively expensive to set up. *See* Bush, *supra* n. 24, at p. 93.

48. *See*, for example, P.A.C. Burgman, *Corporation Tax in the Netherlands: The Institution of the Advance Ruling*, 16 Intertax 10, pp. 297-306 (1988).

49. P.H. Sleurink & M. van der Weijden, *Protocol to The New Treaty with the United States*, 33 Eur. Taxn. 12, p. 422 (1993), Journal Articles & Papers IBFD; S. van Weeghel, *The Improper Use of Tax Treaties: With Particular Reference to the Netherlands and the United States* p. 125 (Kluwer 1998).

50. NL: Kamerstukken II, 1986-1987, 19 700, Hfdst. IXB, no. 36, available at https://repository.overheid.nl/frbr/sgd/19861987/0000110157/1/pdf/SGD_19861987_0004110.pdf (accessed 31 Dec. 2019); *see* H.A. Tulp, *The Foreign Permanent Establishment of a Netherlands Corporation*, 15 Tax Plan. Intl. 11, p. 18 (1988).

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