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Tax Treaties and Abuse: The Effectiveness of the Principal Purpose Test and Some of Its Shortcomings

In this article, Hans van den Hurk sets out his views on the abuse of tax treaties and the effectiveness of the provisions contained in article 29(9) of the OECD Model regarding the principal purpose test (PPT), together with a consideration of some of the drawbacks of the PPT.

1. Introduction

In this article, I will discuss a number of elements of the principal purpose test (PPT) included in article 29 of the OECD Model (2017),[1] whereby the main focus will be on the question of how effective this test can be in practice, as the structure as well as the Commentary on Article 29 of the OECD Model (2017)[2] regarding the PPT are not exactly clear. In addition, I will briefly address the question of whether the PPT could be invoked by countries in situations under a tax treaty that does not contain a PPT and the tax treaty in question does not fall under the "Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting" (the "Multilateral Instrument" or MLI),[3] as a Covered Tax Agreement (CTA) either. It is questionable whether a kind of customary international tax law can be identified that would lead to the PPT actually being applicable under any tax treaty.

2. The PPT: Some Questions

The PPT is included in article 29 of the OECD Model (2017) as a new instrument to counter tax avoidance. Treaty shopping has received increasing attention from various countries in the world in the aftermath of the last financial crisis. Many countries find it a "thorn in one's side" that a company is interposed in a country with "better" tax treaties (i.e. lower or no withholding taxes). The beneficial owner provisions as formulated in articles 10 to 12 of the OECD Model proved to be insufficiently effective for a number of countries to counter this undesirable use. The PPT had to be the solution. Two extremes can be distinguished with regard to an intermediate holding company. On the one hand, there is the intermediate holding company that is inserted between the top holding company and the operating companies with a relatively limited substance. On the other hand, for example, there is the multinational enterprise (MNE) that has active layers of management at work in the country of the intermediate holding company, in addition to factories and laboratories. In both cases, the answer to the question of whether this is a situation in which the company can claim the benefits of the tax treaty seems quite predictable. It becomes more difficult when the actual activities of a company lie somewhere between these two extremes. How much substance does a company need in order for the treaty countries to accept the intermediate holding company and therefore grant it treaty benefits?

What role will the PPT play in this context, as the text and scope are far from clear? The Commentary on Article 1 of the OECD Model (2017)[4] also plays a role in this discussion. There it is explicitly mentioned that even if a tax treaty does not have a PPT, treaty benefits could still be refused if a situation is not in accordance with the "object and purpose" of the tax treaty.[5] This, of course, leads to the question what is the function of the PPT in that case? Does it merely have a signalling function, meaning that the PPT should be interpreted as having a purpose? A final element concerns the question of whether the PPT, which has an identical form in both the OECD Model (2017) and the UN Model (2017),[6] does not give rise to a form of international customary tax law.

3. The PPT: Object and Purpose

3.1. The OECD perspective

The text of the (unclear) PPT in article 29(9) of the OECD Model (2017) reads as follows:

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1. *OECD Model Tax Convention on Income and Capital* (21 Nov. 2017), Treaties & Models IBFD.
2. *OECD Model Tax Convention on Income and Capital: Commentary on Article 29* (21 Nov. 2017), Treaties & Models IBFD.
3. OECD, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (7 June 2017), Treaties & Models IBFD (the "*Multilateral Instrument*" or MLI).
4. Para. 57 *OECD Model: Commentary on Article 1* (2017).
5. The last part of the second sentence in paragraph 57 of the *OECD Model: Commentary on Article 1* (2017) states that: "transactions that constitute an abuse of the provisions of that convention". *See further* section 3.3.
6. *UN Model Double Taxation Convention between Developed and Developing Countries* (1 Jan. 2017), Treaties & Models IBFD. From the perspective of the *UN Model Double Taxation Convention between Developed and Developing Countries: Commentaries* (1 Jan. 2017), Treaties & Models IBFD, the conclusion is different. In paragraph 9 of the *UN Model: Commentary on Article 29* (2017), one can read: "These paragraphs *with appropriate modifications* to reflect the inclusion of the general anti-abuse rule in paragraph 9 of this Article of the United Nations Model Convention are reproduced below" [emphasis added].

> Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

In terms of structure, this text seems to indicate a clear subjective and objective test. The subjective element lies, in principle, with the tax authorities. The tax authorities will have to demonstrate that "unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention".

But how should "in accordance with the object and purpose" be interpreted? The taxpayer has the burden of proof to show that the interposition of a company and the subsequent receipt of treaty benefits is in accordance with the broader objective of the tax treaty. And that is difficult if both the text and the context are factually unclear, perhaps even illogical. Suppose a group of companies opens an intermediate holding company in the Netherlands. Within that framework, that company is an unlimited taxpayer and can, in principle, also apply provisions such as articles 10, 11 and 12 of the tax treaty in question.[7] That is the main rule; after that, the PPT may come into play. This constitutes the exception to the main rule, but an exception is then made to that exception when acting in accordance with object and purpose. The system of main rule and exception can also be found in the Commentary on Article 1(1) of the OECD Model (2017):

> The fact that a person is a resident of a Contracting State does not mean, however, that the person is automatically entitled to the benefits of the Convention since some or all of these benefits may be denied under various provisions of the Convention, including those of Article 29.[8]

Consequently, the conditions for the exception help determine whether treaty rights can be obtained.[9] That makes it difficult to establish what then is object and purpose, which requires additional research. If there is an interpretation problem in tax law, it often helps, where the text of the law is unclear, to consult the Explanatory Memorandum or other documents from the parliamentary debates. The OECD Model does not have such background material. Of course, the Commentaries on the OECD Model can provide information on the intentions of the contracting countries, but this often relates to the specific treaty provision for which the OECD Commentaries were written. In addition, it says nothing about the intentions of the two countries that concluded the tax treaty.[10]

However, object and purpose are two terms that should be interpreted against the background of the tax treaty in question as such and not in the light of specific provisions.[11] As a kind of introduction to the tax treaty, there is an overview of its history.[12] But even that does not help in ascertaining the rationale behind a treaty provision.

3.2. The Vienna Convention (1969) as a guide

The Vienna Convention on the Law of Treaties (1969) (the "Vienna Convention (1969)")[13] does offer a number of guidelines for interpreting a treaty. Article 31(1) of the Vienna Convention (1969) reads:

> 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 the light of its object and purpose.

However, the methodological character of this provision does not immediately clarify how object and purpose should be interpreted in the PPT. In article 31(1) of the Vienna Convention (1969), the following elements can be distinguished: good faith, ordinary meaning, context, and object and purpose. Good faith is the basis.[14] This principle has already been mentioned in a broader context in article 26 of the Vienna Convention (1969), which stipulates that a treaty must be implemented in good faith. The inclusion of good faith in article 31 of the Vienna Convention (1969) plays a somewhat less general role. Here, good faith refers to an interpretation in line with the "ordinary meaning" in the light of the "object and purpose". With regard to "ordinary meaning", a purely textual approach should be followed, as only the text of a provision can indicate the meaning. After all, the contracting parties have used that text to describe the intended effect. The ordinary meaning should be determined by testing it against the context of the treaty and against its object and purpose. But this does not really constitute progress.

Article 31(2) of the Vienna Convention (1969) helps to understand somewhat how article 31(1) might work in practice. This article, which gives concrete guidance on how a treaty should be interpreted, reads as follows:

> The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

7. This article is about treaty shopping in relation to the PPT. That is why I only refer to articles 10 to 12 of the *OECD Model* (2017).
8. Para. 1 *OECD Model: Commentary on Article 1* (2017).
9. M. Lang, *The Signalling Function of Article 29(9) of the OECD Model – The "Principal Purpose Test"*, 74 Bull. Intl. Taxn. 4/5 (2020), Journal Articles & Opinion Pieces IBFD, disagrees. He is of the opinion that whether a criterion is formulated as an exception is not significant. In particular, Lang, *supra*, at sec. 1. writes: "Although the literature and, alas, sometimes the case law of the Court of Justice of the European Union (ECJ) often contain the highly problematic opinion that exception provisions must be given a narrow interpretation, today this position is evidently obsolete and methodologically untenable".
10. I am of the opinion that the *OECD-Models* (2017) and the *OECD Model: Commentaries* (2017) are results of meetings where OECD member countries were present. For this reason, the *OECD Model: Commentaries* (2017) only describes, to a certain extent, the outcomes of these meetings.
11. Hereafter, I will also test object and purpose to paragraph 9 of the *OECD Model: Commentary on Article 29* (2017), but the result does not make us much wiser.
12. However, the *OECD Model* (2017) does describe the history of the formation of tax treaties, and, therefore, the discussions relating to the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project as such, before it gets to the provisions. This is called the "introduction".
13. *UN Vienna Convention on the Law of Treaties* (23 May 1969) (the "*Vienna Convention* (1969)"), Treaties & Models IBFD, also available at https://treaties.un.org/pages/ViewDetailsIII.aspx?src=TREATY&mtdsg_no=XXIII-1&chapter=23&Temp=mtdsg3&clang=_en (accessed 24 Feb. 2021).
14. "*Pacta sunt servanda*".

(a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
(b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

In addition to the text of the treaty, therefore, the preamble and annexes are also important. The preamble forms part of the context of the tax treaty and, as such, is one of the primary sources of law from which the meaning can be derived. For the OECD Model (2017), that preamble reads as follows:

> (State A) and (State B),
>
> Desiring to further develop their economic relationship and to enhance their cooperation in tax matters,
>
> 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),
>
> Have agreed as follows:

So it is these paragraphs that should actually provide insight into what object and purpose are. A question that then arises is what is more important. The literal text or object and purpose? Strange as it sounds, the literal text does not always prevail. This is not the result of a logic through which object and purpose can overrule the interpretation of the literal text with all its consequences, but mainly because the OECD Model has English and French as the most important languages. For example, the Netherlands-Norway Income Tax Treaty (1990)[15] is authentic in Dutch and Norwegian. It is not unthinkable that, after a comparison of the language versions, there are differences between them. For the international tax expert this is familiar territory. When one wants to test legislation against an EU Directive, in case of doubt, other language versions must also be examined. However, the literal text remains the basis of the analysis. Then the focus turns to object and purpose, as these terms are mainly used to find the meaning of a provision in case of doubt about the literal text. According to De Broe (2020), article 31 does not permit a teleological interpretation in the event that it goes beyond what is expressed in the wording of the Vienna Convention (1969).[16] This means that an interpretation based on object and purpose cannot go beyond the text. This situation is a logical conclusion, as the contracting states together have chosen or conceived the text that makes it most clear what effect those states want to achieve with a provision.

3.3. Object and purpose: The OECD perspective

Object and purpose are also described in some detail in the Commentary on Article 1 of the OECD Model (2017). There the following can be read:

> 55. The extension of the network of tax conventions increases the risk of abuse by facilitating the use of arrangements aimed at securing the benefits of both the tax advantages available under certain domestic laws and the reliefs from tax provided for in these conventions.
>
> 56. This would be the case, for example, if a person (whether or not a resident of a Contracting State), acts through a legal entity created in a State essentially to obtain treaty benefits that would not be available directly...[17]

What appears to be the main anchor for the states is the so-called principle of opportunity. In principle, the intermediation of a company opens up a catalogue of treaty benefits. The question then arises as to whether the choice of a company in that country is motivated by the treaty benefits to be gained as a result or by non-tax arguments. Hence, the principle of opportunity. And when a company is interposed in the Netherlands in order to obtain an immediate (direct) advantage, it may not be acting in accordance with object and purpose.[18] It is obvious that the analysis with regard to object and purpose becomes extremely difficult if this intermediary company actually performs entrepreneurial activities. And that may as well involve the active management of Dutch and foreign subsidiaries. For more on this, *see* section 3.4.

Naturally, the Commentary on Article 29(9) of the OECD Model (2017) should also be consulted. Perhaps the OECD Commentary on Article 29(9) (2017) offers some guidance for assessing situations in which an intermediate holding company is inserted into an existing structure in the light of object and purpose. The example that comes closest to the one given in section 2. concerns Example G. This reads as follows:

> Example G: TCO, a company resident of State T, is a publicly-traded company resident of State T. It owns directly or indirectly a number of subsidiaries in different countries. Most of these companies carry on the business activities of the TCO group in local markets. In one region, TCO owns the shares of five such companies, each located in different neighbouring States. TCO is considering establishing a regional company for the purpose of providing group services to these companies, including management services such as accounting, legal advice and human resources; financing and treasury services such as managing currency risks and arranging hedging transactions, as well as some other nonfinancing related services. After a review of possible locations, TCO decides to establish the regional company, RCO, in State R. This decision is mainly driven by the skilled labour force, reliable legal system, business friendly environment, political stability, membership of a regional grouping, sophisticated banking industry and the com-

15. *Convention between the Kingdom of the Netherlands and the Kingdom of Norway for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (12 Jan. 1990), Treaties & Models IBFD.
16. L. De Broe, *Role of the Preamble for the Interpretation of Old and New Tax Treaties and on the Policy of the Prevention of Treaty Abuse*, 74 Bull. Intl. Taxn. 4/5 (2020), Journal Articles & Opinion Pieces IBFD.
17. Paras. 55 and 56 *OECD Model: Commentary on Article 1* (2017).
18. The Supreme Court of Canada (SCC) takes a different view for different reasons. *See* the case of CA: SCC, 19 Mar. 2021, *Her Majesty the Queen v. Alta Energy Luxembourg SARL*, Docket 39113, available at www.scc-csc.ca/case-dossier/info/dock-regi-eng.aspx?cas=39113 (accessed 12 Apr. 2021), in which some members of the SCC argued that the assessment of a tax treaty should be based on the intentions of both contracting states and not only on the intentions of the Canadian government. This makes it quite difficult to base any analysis on a more teleological "object and purpose based" reasoning.

> prehensive double taxation treaty network of State R, including its tax treaties with the five States in which TCO owns subsidiaries, which all provide low withholding tax rates.[19]

The Commentary on Article 29(9) of the OECD Model (2017) describes in this example what can be seen as an explanation of the meaning of object and purpose, when an intermediary holding company can be accepted if there are sufficient business reasons to choose this specific country. Freely translated to the example given in section 2., the choice for the Netherlands as a location to establish the holding company of a group is an acceptable one. However, the remainder of Example G then states:

> ... Assuming that the intra-group services to be provided by RCO, including the making of decisions necessary for the conduct of its business, constitute a real business through which RCO exercises substantive economic functions, using real assets and assuming real risks, and that business is carried on by RCO through its own personnel located in State R, it would not be reasonable to deny the benefits of the treaties concluded between State R and the five States where the subsidiaries operate unless other facts would indicate that RCO has been established for other tax purposes...[20]

Does the example seem to imply an important clarification of the perspective in the first instance? A distinct lack of clarity unfortunately appears in the second part. This all-important consideration contains several open standards: "constitute a real business, exercise substantive functions, real risks" are examples. They are not explained. And finally, there are the words: "established for other tax purposes". What does the word "other" mean here? Does it mean that, if a large Chinese group wishes to establish its headquarters in the Netherlands for the European Union, as the Netherlands quickly refunds the amount in the event of a negative VAT tax declaration, the PPT could apply and treaty benefits could be denied? That cannot be the intention. What "other tax purposes" means is completely unclear. I can only conclude that the Commentary on Article 29(9) of the OECD Model (2017) is not very enlightening and that another way will have to be found to define the meaning of object and purpose.

3.4. The "real economic activity" spectrum

What happens when a company is interposed in, for example, the Netherlands and management activities are carried out for the group in that company? One now seems to have landed in a circular argument. The PPT does not apply (and, therefore, the Dutch intermediate holding company enjoys all treaty benefits) if a situation is in accordance with the object and purpose of the treaty. This must be found in the preamble, which only states that the model treaty does not wish to create opportunities for treaty shopping.[21] This should mean that a Dutch intermediary created here, as a nice treaty network is within reach via the Netherlands can, in principle, be denied the treaty benefits. That cannot be the intention. In this spectrum of possibilities, there are situations at either end that are lawful or unlawful, but between them there is a broad range of situations that are uncertain.[22] The question is how this should be tested.

The wrong end of the spectrum is actually quite clear. It concerns situations where the traditional beneficial owner approach should apply. To illustrate this, one can take an example from Russian case law. Traditionally, investments in Russia were often carried out via Cyprus because of the existence of an interesting tax treaty between those countries. Foreign parties evidently believed that the use of this Cyprus route would be like always winning a lottery.[23] In the case of *Severstal PAO* (2016),[24] a Russian company paid dividends to four Cypriot shareholders in 2011. The company applied the 5% withholding tax rate provided for in the Russia-Cyprus Income and Capital Tax Treaty (1998).[25] During a tax audit, the tax authorities discovered that the Cypriot companies had paid the dividends directly to companies registered in the British Virgin Islands (BVI). According to the tax authorities, these offshore companies were, therefore, the actual recipients of the dividends and should have been subject to withholding tax of 15% instead of 5%. An important additional element in the Russian court's decision was the fact that the Cypriot and BVI boards consisted of almost the same people.[26]

At the other end of the spectrum are the head offices of, for example, US MNEs that actively manage parts of the world through a Dutch entity. In many situations, these are real head offices with mostly additional real activities, for example, in the area of production but also in the area of research and development (R&D). In these situations, it would appear that "object and purpose" is usually met and these situations therefore fall outside the PPT.[27]

In most situations, it is much more of a grey area. What if the head office is established in the Netherlands because of the treaty benefits, but actually employs 150 people who perform real economic activities, for example, in active

19. Para.182 *OECD Model: Commentary on Article 29(9)* (2017).
20. Id.
21. I am focusing only on the traditional forms of treaty shopping to reduce withholding taxes. There are, of course, other forms. I am thinking here, for example, of the intermediary position of a company in a country that does not include the capital gain on a shareholding in the tax. This was dealt with, for example, in the Canadian case of *Alta Energy Luxembourg* (2021), *supra* n. 18.
22. The spectrum review takes place not only at the level of the intermediate company but equally, if not more so, at the level of the underlying entities. They will assess on their own merits whether the holder of a dividend-paying subsidiary resident in their country has sufficient substance to accept a reduction in withholding tax.
23. This shows, in principle, the need for the introduction of an additional test over and above the beneficial owner test.
24. *See* the decision of the Moscow *Arbitrazh* (Arbitration) Court (MAC) in RU: MAC, 31 Oct. 2016, Case No. A40-113217/16-107-982 ("*Severstal PAO*"), Case Law IBFD.
25. *Agreement between the Government of the Republic of Cyprus and the Government of the Russian Federation for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital* (5 Dec. 1998) (as amended through 2010), Treaties & Models IBFD.
26. In this respect, this case differed from the facts as discussed by the Canadian Federal Court of Appeal in CA: FCA, 26 Feb. 2009, *Prévost Car Inc. v. Her Majesty the Queen*, A-252-08, 2008 T.C.C. 231, Case Law IBFD.
27. From experience, I know that, in some countries (for example, Italy and Spain), the approach is different. If an intermediate holding company is chosen in a country where treaty benefits also play a role, it is argued that treaty benefits can be refused on the basis of the PPT, whereby no importance is attached to the question of whether the granting of treaty rights is not in accordance with the "object and purpose".

management or R&D? It would seem defensible to act in accordance with object and purpose in that case, as, when weighing up the reasons for establishing a head office in the Netherlands, greater weight should be given to the application of the main rule of the tax treaty than to the exception to this, namely the PPT. An interpretation in which the PPT would be attributed a broader meaning would make application of the tax treaty largely illusory.

A related question arises in situations where, for example, a US MNE has a Dutch holding company that holds a subsidiary in which all activities are carried out and a subsidiary that only holds the participating interests. In such a situation, it could be argued that the Dutch shareholder does not perform any activities except holding shares and that, for that reason, the PPT should apply. In my experience, this is how many US MNEs are structured. It may be expected that, as a result of the other activities in the Netherlands, the granting of treaty benefits will be in line with object and purpose. The approach that this company "does nothing else" and that therefore the treaty benefits should be denied is understandable from a purely legal assessment of substance. However, especially in a period in which the OECD Model (2017) is working on a much more material economic basis, all of the activities of the company should be taken into account. This also seems to be in line with the reasoning of the Court of Justice of the European Union (ECJ), which concluded as follows in *Deister and Juhler* (Joined Cases C-504/16 and C-613/16):[28]

> In addition, contrary to what the legislation at issue in the main proceedings provides, the finding of such an arrangement requires that, on a case-by-case basis, an overall assessment of the relevant situation be conducted, based on factors including the organisational, economic or other substantial features of the group of companies to which the parent company in question belongs and the structures and strategies of that group.[29]

I conclude from this that, from the point of view of EU law, the entire Dutch part of the group may be taken into account when determining whether the granting of treaty rights to the company that merely holds the shares may be refused on the basis of the PPT. Based on the intention of the tax treaty (State A and State B wish to develop their economic relationship), it would seem reasonable in such a situation to grant the company that holds the shares, but otherwise does not carry out any activities as these are carried out in a sister entity, treaty benefits also in situations where EU law does not play a role.[30]

4. A Few Words on Purposive Interpretation

In the literature, the discussion regarding object and purpose and its consequences for the real economy continues. Lang (2020), for example, finds the discussion with regard to object and purpose a difficult one, and, therefore, promotes purposive interpretation. In his words:

> Consequently, a different reading of article 29(9) of the OECD Model seems more convincing. The provision emphasizes the need for purposive interpretation, without limiting it to the cases covered by the provision. Object and purpose must be considered if "obtaining that benefit was one of the principal purposes of any arrangement or transaction", and also in all other cases of the application of the tax treaty. Accordingly, on the face of it, this subjective requirement for the application of article 29(9) of the OECD Model would become meaningless. However, especially in those cases where obtaining the benefit was one of the principal purposes of the transaction, it is important to remind taxpayers, tax authorities and courts of the necessity of a purposive interpretation.[31]

I find this approach difficult to accept. In sections 2. and 3., theoretical but also practical difficulties with regard to object and purpose were described in a more traditional analysis. But by adopting a purposive interpretation, how helpful this approach may seem to be at first notice, and leaving a more traditional interpretation aside, it seems likely that many companies with real economic activities will be confronted with tax administrations having their own views on the PPT and companies may actually use purposive interpretation in a way to illicitly increase tax revenues.

5. Can the PPT Still Be Applied Even If It Is Not Included in the Tax Treaty?

In sections 1. to 4., I have addressed the question of how the PPT should be interpreted in relation to object and purpose. The next question is whether the PPT may still be applied to situations where the relevant treaty does not provide for this. This can occur, for example, in a situation where country A and country B are part of the "Inclusive Framework", but these countries have not designated the relevant tax treaty under the MLI as a CTA, and as a result the existing older tax treaty remains in force.

Two elements play a role in this. First, the commentary on Article 1. And second, the question that has been raised in the literature whether, since the PPT has been taken as a starting point by almost all countries within the inclusive framework, this has created a kind of customary international tax law.[32] First, the role of the commentary to the OECD OM. Paragraph 57 of that commentary to Article 1 reads:

> Paragraph 9 of Article 29 and the specific treaty anti-abuse rules included in tax conventions are aimed at these and other transactions and arrangements entered into for the purpose of obtaining treaty benefits in inappropriate circumstances. Where however, a tax convention does not include such rules, the question may arise whether the benefits of the tax convention should be granted when transactions that constitute an abuse of the provisions of that convention are entered into.[33]

28. DE: ECJ, 20 Dec. 2017, Joined Cases C-504/16 and C-613/16, *Deister Holding AG and Juhler Holding A/S v. Bundeszentralamt für Steuern*, Case Law IBFD.
29. Id., at para. 74.
30. Having been involved in a number of cases in which Dutch intermediaries were refused treaty rights by various EU Member States on the grounds that they lacked substance, unfortunately, I must conclude that many countries only adhere to the purely legal perspective.
31. Lang, *supra* n. 9, at sec. 2.
32. *See* I.J. Mosquera Valderrama, *BEPS Principal Purpose Test and Customary International Law*, 33 Leiden J. Intl. L. 3, pp. 745-766 (2020).
33. On the Inclusive Framework, *see* OECD, *About the Inclusive Framework on BEPS* (OECD), available at www.oecd.org/tax/beps/beps-about.htm/ (accessed 25 Mar. 2021) and, *Signatories and Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*: Status as of 20 April 2021 on CTAs,

The OECD approaches this from two angles. First, some states consider that the abuse of a tax treaty is, in fact, an abuse of domestic law. The question then arises whether a tax treaty prevents the application of national anti-abuse provisions.[34] The other approach is that abuse, in principle, implies abuse of the treaty itself, and then the refusal of treaty benefits results from a reasoning based on the previously discussed element "object and purpose" (*see* section 3.3.), whereby that tax treaty must be interpreted in "good faith".[35] According to the Commentary on Article 1 of the OECD Model (2017), states may refuse treaty benefits in both cases.

However, it becomes extremely complex when the Commentary on Article 1 of the OECD Model (2017) mentions that in addition to the PPT, a main purpose test should actually apply, regardless of whether the treaty has a PPT. The Commentary on Article 1 of the OECD Model (2017) states the following:

> It is important to note, however, that it should not be lightly assumed that a taxpayer is entering into the type of abusive transactions referred to above. 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. That principle applies independently from the provisions of paragraph 9 of Article 29, which merely confirm it.[36]

The fact that it cannot simply be assumed that a taxpayer wishes to abuse the treaty indicates that the OECD has a realistic view on this. Structures as simplistically implemented as in the Russian cases mentioned in section 3.4. are rare. With regard to tax avoidance, the OECD applies a main purpose test as a guiding principle. Then, things become less clear. This main purpose test should be applied independently of the PPT so there is actually a double test if the treaty also has a PPT. But then the last sentence of the Commentary on Article 1 also says that the PPT actually "simply" confirms the main purpose test.[37] If that is the only added value of the PPT, one may consider why it was introduced. The reason for the separate inclusion of a PPT seems to be the principle that some tax avoidance techniques can be better combated with specific rules. But this seems unnecessary here if the PPT only confirms the main purpose test. There is also the argument that the PPT would provide good support for countries that do not have adequate anti-abuse provisions.[38]

The OECD states that even without the PPT, the effects as envisaged by the PPT can be enforced through this approach of the Commentary on Article 1 of the OECD Model (2017). But even that does not seem logical if the role of the PPT can only be seen as an endorsement of the main purpose test.

This can prompt discussions about whether the emergence of some kind of customary international tax law is desirable. The PPT is generally accepted within the Inclusive Framework and by the signatories of the MLI. Is that enough to create a kind of customary rule of international tax law? The PPT has been presented in Action 6 of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project as the anti-avoidance tool.[39] Some experts would cautiously agree with this approach.[40] The OECD takes the example of a country that does not participate in the Inclusive Framework and does not sign the MLI either. Can that country then argue, when applying the tax treaty between that country and a third country, that given that the PPT aims to prevent tax avoidance and, because it is accepted by much of the world, it may be applied as a general rule? If it can, then customary international tax law has been created. It remains to some extent an academic debate whether this is right and what are the consequences. As with the Commentary on Article 1 of the OECD Model (2017) and article 29(9) of the OECD Model itself, this will depend on the national court and whether it is prepared to apply such extensive reasoning. Another argument against this is that many elements have been included in what is called the minimum standard, including the PPT.[41] The reason for this is that these elements are so essential that they cannot be missed. But if the PPT were to become customary international tax law, how could it then be missed?[42]

Things become even more complicated if countries that really go in a different direction are included in the discussion. For example, the United States has opted for a limitation on benefits provision. This provision, which has been in use for years, works well for the United States with a number of related treaty provisions, but it is difficult to apply to other countries. The question then arises, if there could be customary law, whether the United States could invoke the PPT on the basis that customary international tax law exists.

Another interesting question is what happens if a dispute over whether an intervening company can claim treaty rights leads to arbitration. Arbitrators will assess all the facts and circumstances of the case in order to reach a decision. It is not inconceivable that they will apply the test of why it was chosen to establish that company within a certain jurisdiction. And while a national court will probably not review the Commentary on the Model in all cases,

available at www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf (accessed 6 May 2021).

34. *See*, among others, paragraph 58 of the *OECD Model: Commentary on Article 1* (2017).
35. Id., at para. 59.
36. Id., at para. 61.
37. Id., at para. 61.
38. Id., at para. 62.
39. *See*, for example, OECD, *Action 6 Final Report 2015 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* (OECD 2015), Primary Sources IBFD.
40. *See* Mosquera Valderrama, *supra* n. 32, at p. 21, who concludes that: "Based on the analysis of the objective element (state practice) and subjective element (accepted as law), there are indications that this principal purpose test can be regarded as a principle of customary international tax law".
41. Arts. 6 and 7 MLI.
42. Or would the minimum standard be a development, which was as such created, without having the intention to create this?

it is obvious that arbitrators in such a situation will look to this Commentary for guidance as to purpose and scope.

Does this mean that one may conclude that as a result of the Inclusive Framework there is customary international tax law? I doubt it. Some kind of customary international tax law seems likely to emerge. However, in my opinion, the reason for this is not so much due to the Inclusive Framework, the MLI and so on, but much more due to the Commentary on Article 1 of the OECD Model (2017), which makes it clear that a treaty has, in principle, a main purpose test, and that the PPT merely confirms this test. If it is not confirmed (simply because that treaty does not have a PPT), this does not mean that the main purpose test as mentioned in the Commentary cannot apply. This very specifically creates a sort of customary international tax law, which consists of always being able to apply the main purpose test as mentioned in the OECD Commentary on Article 1 (2017) rather than the PPT. Whether this will happen in practice depends to a large extent on whether the courts in the various countries of the world consider the OECD Commentary on Article 1 (2017) to be relevant enough to apply.

However, it goes without saying that, if the inclusive framework was perceived as relevant enough to create customary international tax law, this has consequences for the rule of law, as it is tax administrators at the Inclusive Framework who are designing these mechanisms, not domestic parliaments. Consequently, the risk of self-serving is very real.

A last question relates to the previous discussion regarding purposive interpretation. If purposive interpretation were the way to actually "use" the PPT, such results approximate customary international tax law. Though close, still it is clearly not the same. Purposive interpretation does not look at the theoretical background of the PPT, as, for this method, the PPT is hardly relevant, and is only accepted for its signalling function while the discussion regarding customary international tax law departs from the PPT as such in all its aspects. As stated in the previous paragraph, purposive interpretation does not appear to be the way forward. I would clearly prefer a reasoning based on a highly thorough analysis of the PPT, even when object and purpose remain vague, then getting into a situation where the rights of a company are in the hands of a tax inspector who has his own views on the way a treaty should be interpreted and uses these.

6. Third State Inclusion in the Debate

The PPT is unclear, its object and purpose do not bring us much further, and the idea that through the Commentary on Article 1 of the OECD Model (2017) or through common law an extra type of PPT (whether in the form of the main purpose test) could apply only complicates the question whether a company can claim treaty rights. The balance between the effectiveness of a treaty and the legal certainty needed for companies operating in several countries is skewed. And that is worrying.

But what to do next? If the PPT is to be seen as an effective test of "real economic activity", in my opinion, it would only be appropriate if the PPT is combined with a mutual agreement procedure (MAP) and, should the countries concerned be unable to reach a unanimous conclusion, compulsory binding arbitration. The interest of states in not being confronted with tax avoidance may be great, but, in a world where companies are spreading their activities around the globe, states should at least have the certainty that they will not be confronted with double taxation. Even then, the solution of compulsory binding arbitration may hurt, but, at least, there will be no more double taxation. With this in mind, the question arises as to whether, precisely because of this multinational nature of how companies operate, an even broader view should be taken. In other words, should a consultation procedure between an intermediate holding company and the subsidiary not also include the country where the head office is? It will not be easy, but if the elimination of double taxation is still the aim of the 15 Actions of the OECD/G20 BEPS Project, and the new tax conventions which created many open norms, then it is worth discussing this. It would be a wonderful challenge for a potential PhD student to conduct research into the future of multilateral dispute resolution.

7. Conclusions

The relationship between the rights of countries and companies seems to be out of balance. In this discussion, the PPT in all its facets plays an important role. The PPT is vague, other references also remain vague. However, any other way to apply the PPT, whether via a purposive interpretation or perceiving it as customary international tax law, leads, in my opinion, to an unacceptable subversion of the rule of law. It gives a tax administrator the power to determine the tax result, despite the result of tax legislation or a tax treaty.

However, we should not forget to also take dispute resolution into account. In a decent society, double non-taxation should be avoided, but the same applies to double taxation. In this respect, one major question is still open. Should not the third state be involved one way or another in any double (non)taxation discussion between intermediary headquarters and subsidiary, as endless discussions about real economic activity can in many cases only be solved when states obtain input from third states? This helps the states that want to make sure they receive what they are entitled to as well as companies, as the threat of double taxation would be removed.