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Is BEPS Action 6 “Preventing Treaty abuse” compatible with the EU Law concept of abuse?

by

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SUMMARY

In September 2015, the OECD released the final report on BEPS action 6. The main purpose of the action 6 is the prevention of “granting treaty benefits in inappropriate circumstances”. Regarding the prevention of treaty abuse the OECD presented three main recommendations. These actions are only proposals and therefore they constitute soft law. However with their implementation in the tax treaties and domestic law they will become hard law. Thus, the BEPS action 6 recommendations will have legal consequences in the taxpayer’s cross-border activities and in the domestic legal system.

In the EU, Member States still have the competences to design their tax legislation. In addition they are free to conclude bilateral tax agreements with the aim to avoid double taxation. However, under the principle of “sincere cooperation” these competences have to be exercised in line with the EU Law. Consequently the Member States of the EU have the obligation to take EU law into consideration when implementing the proposed measures under the OECD BEPS action 6.

Therefore, the question of the conformity of the BEPS action 6 proposals with the EU law gives rise. In this context, the master thesis topic is focused in the examination of the proposals and their compatibility with the EU law.

As the proposed recommendations concern anti –abuse rules which could give rise to restriction of the fundamental freedoms the CJEU states that it is possible to be justified on the basis of tax avoidance. It is concluded that the EU law concept of abuse constitutes a benchmark regarding the situations where application of the anti-abuse rules by the MS is allowed.

Thus, a confrontation of the concept of abuse under the proposed anti-abuse rules and the one under the settled CJEU case law takes place. Further, the thesis makes also a comparison with the abuse concept found in the anti -abuse rules of the EU secondary law. However, it is concluded that MS cannot directly rely on the anti-abuse rules under the EU Tax Directive.

Finally, the author concludes that the proposed anti –abuse rules are not in line with the EU law concept of abuse as they do not target only “wholly artificial arrangements”. Thus, the restriction would be not justified under the ground of tax avoidance. In this context, Member States of EU have to be careful in the implementation of the proposals by limiting their application only to abusive practices accepted by the CJEU.

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Abbreviations

AG	Advocate General
BEPS	Base Erosion Profit shifting
CJEU	Court of Justice of the European Union
EU	European Union
GAAR	General Anti-Abuse rules
LOB	Limitation on Benefits Clause
MNEs	Multinational Enterprises
MS	Member States of the European Union
OECD	The Organization for Economic Co-operation and Development
OECD MC	The OECD Model Tax Convention
PPT	The Principle Purpose Test
PSD	Parent-Subsidiary Directive
TEU	The Treaty on the European Union
TFEU	The Treaty on the Functioning of the European Union
VCLT	Vienna Convention on the Law of Treaties

1. INTRODUCTION

1.1. Background

With the globalization, company's opportunities to arrange their activities in the most efficient business structures have increased. In addition, the extension of bilateral tax treaty agreements on the elimination of double taxation has also given a positive effect on their cross-border activities.¹

In general, countries have treated international tax planning as a legitimate practice, unless it was an abusive behavior. However, over time, corporate have become more aggressive in their tax planning strategies, in order to benefit from the differences in the state's tax legislations.²

Mostly all the strategies used by taxpayers in the area of aggressive tax planning involve tax treaties with the aim to shift their incomes to lower jurisdictions, to avoid domestic rules and often to benefit from tax treaties that were not entitled. This often is achieved by being engaged in treaty shopping or other treaty abuse structures.³

Treaty abuse has become a global issue as the tax planning of taxpayers has become more sophisticated and their incomes often result untaxed. In this context, not only states but also international bodies as the OECD and EU Commission are involved in addressing effectively treaty shopping and treaty abuse situations.⁴

In the light thereof, it is not surprising that treaty abuse is one of the actions of the OECD/ G20 Base Erosion and Profit Shifting (BEPS) project. On October 2015 the OECD published the final Report of the work of the OECD/G20 on the BEPS action 6 "Preventing the granting of Treaty Benefits in Inappropriate Circumstances" where OECD proposed the three-pronged approach on preventing treaty abuse.⁵ The first recommendation regards the inclusion in the tax treaties of a special-anti abuse rule as the Limitation on Benefits clause (LOB) which would prevent the granting of the treaty benefits to residents that do not fulfill its requirements. Second recommendation concerns the incorporation of a general anti-abuse rule as the Principle Purpose Test (PPT) in order to address other forms of treaty shopping situations that the LOB would not cover. The third recommendation refers to the amendment of the title and preamble in order to

¹ Kim Brooks, "The Potential of Multilateral Tax Treaties", Lang, M, & Pistone, P. (ed), "Tax Treaties : Building Bridges between Law and Economics", (IBFD 2010), Part IV, p. 218

² Commission Recommendation 'on aggressive tax planning', C(2012) 8806 final, para.1

³ OECD, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report, OECD/G20 Base and Erosion Profit Shifting Project, OECD Publishing 2015, p. 9, Hereafter "BEPS Action 6 Final Report"

⁴ OECD, OECD/G20 Base and Erosion Profit Shifting Project, OECD Publishing 2013, Hereafter "OECD BEPS Project 2013";

⁵ OECD, "BEPS Action 6 Final Report" (n 3)

have a clear statement that the purpose of the tax treaties is not intended to generate opportunities for treaty abuse.⁶

According to the OECD, treaty abuse especially treaty shopping is “*one of the most important source of BEPS concern*”.⁷

Under primary EU Law, although the treaty shopping could result in base erosion and profit shifting it would not be classified as an abusive practice, until when the taxpayer effectively exercises the fundamental freedom laid down in the TFEU.⁸ Also the loss of tax revenues and tax base erosion has been systematically rejected by the CJEU as a justification ground for restrictive rules.⁹ Regarding the “forum shopping” phenomenon, which involves the situations where a taxpayer shops the most favorable tax jurisdictions in order to low its tax burden, the CJEU consistently held that the mere fact that the national of a MS choose the most favorable tax treatment it cannot constitute abuse of the fundamental freedoms.¹⁰ In the *Cadbury Schweppes* case, which is known as the leading case in direct taxation field regarding the concept of abuse, the CJEU in its judgment stated that a taxpayer will be engaged in abusive practices only if the reduction of the tax burden is a result of “wholly artificial arrangements”.¹¹

Instead, under the EU tax Directives, the concept of avoidance is wider than that established by the CJEU in the *Cadbury Schweppes*.¹² Also in the EU Commission Recommendation “*On the implementation of measures against tax treaty abuse*” released in January 2016, a broader concept of avoidance is found.¹³ Whatever, the form of the concept of abuse under secondary EU law, they must target only the arrangements which are wholly artificial.

In the light of all above, the tax avoidance concept under primary EU law and BEPS action 6 may fundamentally differ, where the latter does not focus only on the “wholly artificial arrangements”.¹⁴

A conflict between these two concepts would give rise in the moment when the proposed rules of the OECD will be implemented in the domestic law and tax treaties of the Member States of

⁶ OECD, BEPS Action 6 Final Report” (n 3), p. 9

⁷ Ibid, p. 9

⁸ Case C- 196/04, *Cadbury Schweppes v. Commissioners of Inland Revenue*, [1996] ECR I-7995, para. 35 - 55

⁹ See e.g Case C- 270/83, *Commission v. France “Avoir Fiscal”*, [1986] ECR 273, para.25 ; Case C- 264/96, *Imperial Chemical Industries “ICI” v. Kenneth Hall Colmer*, [1998] ECR I-4695, para. 28

¹⁰ Case C- 212/97, *Centros Ltd v Erhvervs-og Sel –skabsstyrelsen*, [1999] ECR I-1459, para. 20

¹¹ Case C- 196/04, *Cadbury Schweppes* (n 8), para. 55

¹² Frans Vanistendael, “Is Tax Avoidance the Same Thing under the OECD Base Erosion and Profit Shifting Action Plan, National Tax Law and EU Law”, (2016), *Bulletin for International Taxation* , IBFD, p.170

¹³ Commission Recommendation ‘on the implementation of measures against tax treaty abuse’, C(2016) 271, para.2 of the recommendation

¹⁴ Frans Vanistendael, “Is Tax Avoidance the Same Thing under the OECD Base Erosion and Profit Shifting Action Plan, National Tax Law and EU Law” (n 12), p.170

the EU. Hence, countries outside the EU are free to implement the proposals in the way they want. Instead Member States when implementing treaty based anti- abuse rules have to respect the fundamental freedoms and the EU abuse concept.¹⁵

1.2. Aim

*“Although direct taxation falls within their competence, the Member States must none the less exercise that competence consistently with Community law”. (ACT IV GLO)*¹⁶

Consequently the Member States of the EU have the obligation to take EU law into consideration when implementing the proposed measures under the OECD BEPS action 6.

Therefore, the aim of this master thesis is to analyze the compatibility of the BEPS action 6 with EU law. In the thesis, the three recommendations under the BEPS action 6 are scrutinized separately: the Limitation on Benefits (LOB) rule, the general anti-avoidance rule (GAAR) and the amendment of the title and preamble of the OECD MC, with the aim to examine the question of whether the concept of tax avoidance under these recommendations is in line with the settled CJEU case law on anti-abuse rules. Within the analyses a special focus is given to the issue of the legal uncertainty as a result of vague and imprecise wording of the BEPS action 6 proposed rules.

Moreover, the author also reviews the changes of the recent EU actions tackling aggressive tax planning, as the inclusion of a GAAR in the Parent-Subsidiary Directive¹⁷ and the EU Commission Recommendation *“On the implementation of measures against tax treaty abuse”*.¹⁸

Finally, as the concept of avoidance differs under the different sources of law the author aim is to extract a guidance for the EU Member State’s policy makers regarding the conditions under which the anti-abuse rules could be applied.

¹⁵ Christiana HJI Panayi, The Compatibility of the OECD/G20 Base Erosion and Profit Shifting Proposals with EU law, (2016), Bulletin for International Taxation , IBFD, p.109

¹⁶Case C-374/04, Test Claimants in Class IV of the ACT Group Litigation v Commissioners of Inland Revenue, Hereafter ACT IV GLO [2006] ECR I-11673, para. 36

¹⁷ Council Directive (EU) 2015/121 of 27 January 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States , [2015], OJ L21/1, article 1

¹⁸ Commission Recommendation ‘on the implementation of measures against tax treaty abuse’ (n 13), p.2 of the recommendation

1.3. Method and material

As the thesis purpose is to analyze whether the OECD proposals under the BEPS action 6 are compatible with the EU law, the most appropriate method to be used is the legal dogmatic method. This method follows an internal perspective. In this context, the legal system which raises this research question will be also the framework of the analyses.¹⁹

The method is composed by two steps: First, the sources of law will be presented and second, these sources have to be interpreted and confronted with each other.²⁰

The author firstly presents and analyzes the phenomenon of improper use of the tax treaties and the techniques developed at the level of domestic law and the international organization OECD. Regarding the presentation of the techniques developed at the international level, the OECD Commentary 2003 is used because of its proposed recommendations in addressing treaty abuse. In addition, the author refers also to the relevant academic literature which give a detailed inside into the issue of improper use of tax treaties.²¹ In the next step of the thesis, author continues to analyze the changes in the tax treaties proposed by the BEPS action 6 in order to prevent treaty abuse. This analyze is supported by current OECD Commentary of 2014 and the relevant OECD released reports regarding the BEPS action 6.

For the comparison of the BEPS 6 with EU law, firstly the author presents the relevant sources of EU law such as CJEU case law concerning the MS competences and duties regarding the international agreements provisions.²² Secondly, the thesis analyzes the settled CJEU case law regarding the anti –abuse rules, in order to establish a benchmark against which the proposed OECD anti-abuse rules are confronted.

Furthermore, the author analyze EU secondary law such as the GAAR included in the Parent-Subsidiary Directive and also with the EU Commission recommended GAAR released in January 2016 in order to deepen the comparison of BEPS action 6.

In order to enhance the academic value of the analysis, this thesis also refers to doctrinal debates, books and commentaries either supporting the BEPS action 6 proposals or criticizing them.

¹⁹ Sjoerd Douma, *Legal Research in International and EU Tax Law*, (Kluwer Law 2014), p. 18

²⁰ *Ibid*, p. 20

²¹ See e.g. Christiana HJI Panayi, *Double Taxation, Tax Treaties, Treaty-Shopping And The European Community* (Alphen aan den Rijn : Kluwer 2007), S. Avi Jounah and Christina HJI Panayi, “Rethinking Treaty Shopping : Lessons for the European Union”, Lang, M, & Pistone, P. (ed), “Tax Treaties : Building Bridges between Law and Economics”, (IBFD 2010),

²² See e.g. Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraph 32 ; *Metallgesellschaft and Others*, paragraph 37; and Case C-471/04 *Keller Holding* [2006] ECR I-2107, paragraph 28

1.4. Delimitation

The BEPS project involves 15 Action plans and while they do link with each other, this thesis concentrates only on the BEPS Action 6. The BEPS action 6 is composed by three areas in which actions should be taken, however, only the three –pronged approach to counter treaty abuse situations will be analyzed in details.²³ The final report on action 6 did not yet introduced a final LOB clause because of the new introduced LOB provision in US which is delivered for public comments. According to the OECD the final version of the LOB clause will be present in the first part of 2016.²⁴ For this reason the author will only discuss the draft proposal of that clause by focusing in the derivate benefits test which is presumed to ensure to the LOB clause the compatibility with EU law. Also it is important to mention that the author cannot account for the forthcoming changes of the LOB clause. During the analyze of the proposed PPT rule the EU secondary law’s anti-abuse rules will be mentioned but not analyzed in details.²⁵

1.5 Outline

The thesis is divided into the following chapters: Chapter 2 of the thesis is aimed at giving insight of the issue of treaty shopping and the domestic and OECD approach. Then Chapter 3 of the thesis continues to analyze the OECD/G20 BEPS Action 6 final report proposals by giving a critical view of the proposed three-pronged approach to counter treaty abuse and treaty shopping situations. Chapter 4 begins with a comparison of the concepts of avoidance under the OECD BEPS action 6 and the EU law by listing the differences between them, then before analyzing the compatibility of the proposed anti –abuse rules the author describes the duty of Member State’s domestic and treaty provision to comply with EU law and the concept of abuse. After the LOB clause, PPT rule and the purpose of double non-taxation are analyzed separately, in the light of EU law. The thesis ends with final conclusions in Chapter 5.

2. BACKGROUND

2.1 International tax planning through Tax Treaties

Bilateral tax treaties have played an important role in facilitating international trade and commerce by easing taxpayer’s cross- border activities. These treaty agreements concluded by two countries define the allocation of taxing powers with the view to reduce tax obstacles of

²³ OECD, BEPS Action 6 Final Report’ (n 3), p. 9

²⁴ OECD, BEPS Action 6 Final Report’ (n 3), p. 9

²⁵ Council Directive (EU) 2015/121 of 27 January 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States , [2015], OJ L21/1, article 1 and the Commission Recommendation ‘on the implementation of measures against tax treaty abuse’ (n 13), p.2 of the recommendation

investing, trading and moving of persons across borders. The major objective of the tax treaties is the avoidance of double taxation derived from the overlap of different fiscal jurisdictions.²⁶

Although the aim of the treaties is avoiding double taxation, individuals and business entities by means of aggressive tax planning strategies use the tax treaty network with the purpose of avoiding taxes. In other words, the taxpayers by different techniques use the advantages given by the treaties in order to shift their incomes to lower jurisdictions, to avoid domestic tax rules or benefiting from tax treaties that were not entitled by using another taxpayer. The latter is known as the phenomenon of “treaty shopping”, a tax planning strategy where a taxpayer “shops” the most appropriate tax treaty to achieve a lower tax burden or a double non-taxation.²⁷

In this context, aggressive tax planning through tax treaties leads to an improper use of tax treaty network resulting in national tax base erosion and profit shifting.²⁸

2.2 Improper use of Tax treaties

It is generally accepted that taxpayers may structure their affairs in the most tax efficient way by using the advantages of the differences between different tax jurisdictions and tax treaties.²⁹

However, some forms of tax planning may constitute improper use of the tax treaties. The issue of improper use of tax treaties was raised since the first OECD Commentary 1977, even though without any proper definition. In the Commentary the concept “improper use” catches situations that have different degrees of artificiality from the ones structured for benefiting from tax treaties and without any economic substance to the ones that have economic substance and benefiting from the tax treaties is one of the purposes.³⁰

In this context, although a taxpayer may comply with all the tax authorities and law requirements, he could be acting against the object and purpose of the law “treaty” which results in an improper use of the tax treaties.³¹

Under OECD commentary 2003 “Treaty shopping” is perceived as an improper use of tax treaties.³² Its structures can be divided in three major groups:³³

²⁶ Michael Lang, Treaty abuse in Introduction to the Law of Double Taxation Conventions, (7th edn, IBFD 2013), Online Books IBFD, p.30

²⁷ Christiana HJI Panayi, Double Taxation, Tax Treaties, Treaty-Shopping And The European Community (Alphen aan den Rijn : Kluwer 2007), p 34-37

²⁸ OECD, “BEPS Action 6 Final Report” (n 3), p. 9

²⁹ Commission Recommendation ‘on aggressive tax planning’ (n 2), para. 1

³⁰ Christiana HJI Panayi, Double Taxation, Tax Treaties, Treaty-Shopping And The European Community (n 27), p.34-37

³¹ Commission Recommendation ‘on aggressive tax planning’ (n 2), para. 1

³² OECD, Commentaries on the Articles of the Model Tax Convention, Model Tax convention (Condensed Version), (OECD Publishing, 2015) para. 9, 11,20 p. 65, Hereafter “OECD Commentary “2003-2014”

³³ Christiana HJI Panayi, Double Taxation, Tax Treaties, Treaty-Shopping And The European Community (n 27), p.38

1. Treaty shopping through conduits companies;
2. Bona fide commercial arrangements;
3. Treaty shopping through intermediaries companies with de minimis economic substance.

Hence, the first structure “through conduit companies” has abusive nature and is one of the most important examples of the treaty shopping situations. The second structure is set up for purely commercial reasons but it also fits into the treaty shopping situations. As for the first two structures it is easier to distinguish between tax avoidance and tax mitigation in the third situation it becomes more difficult to draw the line. It is the tax authorities the discretion to determine if it is improper use of the treaty or a legitimate tax planning.³⁴

In this context, for the countries concerned it is important to ensure that the tax treaty benefits are granted only to those taxpayers that are entitled.³⁵

2.3. Countering treaty abuse and treaty shopping

As shown above, the improper use or abuse of tax treaties exists. Being aware of that, countries and the OECD have developed ways to address treaty abuse and treaty shopping.

2.3.1 Domestic anti-abuse provision

At domestic level, countries have introduced anti-avoidance rules in their tax codes or in their treaties in order to combat the perceived abuse of their tax legislation and to deny the granting of benefits of their bilateral tax treaties. States have also developed anti-avoidance doctrine from the court case law.³⁶ Both of the measures in some circumstances have overridden existing treaty obligations. The determination if a tax treaty can be overridden by new domestic tax legislation depend how the treaty is implemented into the domestic law.³⁷

Generally is accepted that states jurisdictions can be categorized as either monist or dualist. The monist country perceps the international law as being part of their domestic legal systems. Thus, the adoption of the tax treaties within the domestic law will occur automatically. Where is a conflict between domestic law and treaty provisions the domestic law does not apply. Instead, the dualist country perceps the international and domestic law as two separates legal systems.

³⁴ S. Avi Jounah and Christina HJI Panayi, “Rethinking Treaty Shopping : Lessons for the European Union”, Lang, M, & Pistone, P. (ed), “Tax Treaties : Building Bridges between Law and Economics”, (IBFD 2010), Part 2, p. 24

³⁵ OECD, “BEPS Action 6 Final Report” (n 3), p. 9

³⁶ Luc 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, 2008), p.280

³⁷ Craig Ellife, The lesser of two evils: Double Tax treaty override or treaty abuse? (1/62-68), (B.T.R 2016), p. 3

The treaty is adopted within the domestic law only by the approval of the legislature, which means that the legislature can pass also new rules that could override the tax treaty provisions.³⁸

Although some states permit that specific domestic law overrides treaty obligations, in the international law such override is considered as a breach of treaty itself. As tax treaties are part of the international law they legal effects are embodied in the VCLT. Article 26 of VCLT requires states to conclude tax treaties “*in good faith*” and to apply the principle of “*pacta sunt servanda*” when the treaty is adopted. The principle of “*pacta sunt servanda*” does not allow states to invoke domestic law to justify that they did not fulfill their obligation under the tax treaties.³⁹

The OECD 2003 commentary suggests that states do not have to grant the treaty benefits to taxpayers when those arrangements constitute treaty abuse. However, the OECD commentary is not a valid source to be used by the states as an interpretation source to justify their non-performance under the international law.⁴⁰

This conflict is part of the work of the BEPS project under the BEPS action 6 which will clarify that under abusive situations domestic law override is acceptable and justified.⁴¹

2.3.2 The OECD approach

Tackling improper use of tax treaties is not a new aim of the OECD body. Also in the OECD Report for Conduit Companies the risk of treaty shopping has been recognized.⁴²

Some practices of ensuring that the tax advantages of a tax treaty are enjoyed only by that person who is entitled and that the treaty is not used improperly to obtain an unintended benefit have existed since the OECD MC of 1977: As the Beneficial Ownership Clause and the Limitation on the Residence. For instance the limitation on the residence rule requires that the taxpayer should be resident in one of the contracting states. However, the threshold is too low and taxpayers can easily fulfill the requirements.⁴³

³⁸ Craig Ellife, The lesser of two evils: Double Tax treaty override or treaty abuse? (n 37), p.4

³⁹ Ibid. p.13

⁴⁰ Guido J.M.E Bont, Tax Treaty Interpretation in Netherlands, Michael Lang (ed), Tax Treaty Interpretation , (Kluwer Law International 2001), p. 246

⁴¹ OECD, BEPS Action 6 Final Report” (n 3), p. 17

⁴² OECD, R (6) Double taxation conventions and the use of conduit companies (adopted by the OECD Council in 1986), in Model Tax Convention on Income and Capital 2014 (Full version), (OECD Publishing 2015), here after “OECD Report for Conduit Companies”, para.2, p.2

⁴³ Christiana HJI Panayi, Double Taxation, Tax Treaties, Treaty-Shopping And The European Community (n 27), p.43-44

Nevertheless, from 1977 until the 2003 revision, the Commentary affirmed that the purpose of tax treaties was to facilitate trade and investments by eliminating double taxation. It was only in 2003 revision of the Commentary on article 1 of the OECD MC, that OECD changed its view on the tax treaty abuse and treaty shopping. The Commentary for the first time emphasized that the prevention of tax evasion and avoidance is one of the purposes of the tax treaties.⁴⁴ It also presented the relationship between domestic anti-avoidance rules and the treaties by stating:

“States do not have to grant the benefits of a double taxation convention where arrangements that constitute an abuse of the provisions of the convention have been entered into”.⁴⁵

The revised Commentary in 2003 suggested the application of specific treaty based anti-abuse rules which could prevent particular situation of tax avoidance. Even though OECD does not give a proper solution to tackle treaty abuse however it gives some suggestions to treaty negotiators to consider when looking for a solution as: The beneficial ownership approach, look through approach, subject-to-tax clauses and the limitation on residence provision. It went further by suggesting the limitation on benefit “LOB” provision as the one laid in the US treaties.⁴⁶

The OECD Commentary 2003 in the paragraph 9.5 offered also a “guiding principle” which allows states to not grant treaty benefits when two elements are involved: *“a main purpose for entering into certain transactions or arrangements was to secure a more favorable tax position and obtaining that more favorable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.”* However, the paragraph 9.5 also included a limitation on the presumption of the taxpayer’s transactions by noting that *“it should not be lightly assumed that a taxpayer is entering into the type of abusive transactions”*.⁴⁷

In recent years, the issue of treaty shopping seems to have reached the agenda of the G20/OECD project in Base Erosion and Profit Shifting (BEPS), which could mean that the revised Commentary of 2003 was not efficient and many states did not follow the OECD recommendations.⁴⁸

⁴⁴ Luc De Broe and Joris Luts, BEPS action 6: Tax Treaty Abuse, Intertax 43/2, (Kluwer Law international, 2015), p. 122-123

⁴⁵ OECD, “OECD Commentary 2003/2014”, (n 32) para.9.4

⁴⁶ Ibid, Art.1, para. 12-21.5

⁴⁷ “OECD Commentary 2003-2014”, (n 32) para. 9.5

⁴⁸ Luc De Broe and Joris Luts, BEPS action 6: Tax Treaty Abuse, (n 44), p. 123

3. BEPS Action 6 - “Prevention of Treaty Abuse”

3.1 General Remarks

Since July 2013 the OECD initiated the project on addressing profit shifting and base erosion, which was fully endorsed also by the G20. The action plan purpose is to ensure that profits are taxed where the “*economic activities generating the profits are performed and where the value is created*”. According to OECD a shift in international tax policy is needed by the growing awareness that:

*“A number of indicators show that the tax practices of some multinational companies have become more aggressive over time, raising serious compliance and fairness issues.”*⁴⁹

However, the OECD stated the need of consensus and multilateralism among countries:

*“If the Action Plan fails to develop effective solutions in a timely manner, some countries may be persuaded to take unilateral action for protecting their tax base, resulting in avoidable uncertainty and unrelieved double taxation”*⁵⁰

The project is composed of 15 actions to be taken on different tax areas, including transfer pricing, digital economy, anti-avoidance and transparency. These actions should provide the countries with proper solutions to tackle the corporate profit shifting to lower tax jurisdictions.⁵¹

The BEPS Action 6 “Preventing the Granting of Treaty Benefits in Inappropriate Circumstances” considers tax treaty abuse and treaty shopping as one of the most important phenomenon that contribute in base erosion and profit shifting. In this regard, BEPS action 6 principal purpose is:

*“The development of model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances”*⁵²

In this context, on September 2014 the OECD published a report with recommendations on action 6.⁵³ This report was delivered after the two discussions drafts concerning the same issue

⁴⁹ OECD, “OECD BEPS Project 2013” (n 4),p. 6

⁵⁰ OECD, “OECD BEPS Project 2013” (n 4)

⁵¹ Ibid

⁵² OECD, “BEPS Action 6 Final Report” (n 3), p. 9

⁵³ OECD, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances –Action 6: 2014 Deliverable (OECD 2014)

on March 2014.⁵⁴ It was only on October 2015 that OECD presented the final report on BEPS action 6 with emphasizing these three areas in which actions need to be taken:⁵⁵

- 1- The development of new provisions in the model treaty and recommendations regarding the design of domestic rules to prevent granting of treaty benefits in inappropriate circumstances;
- 2- A clarification that the treaties aim is to avoid double taxation and to be used to generate double non-taxation.
- 3- Identifying tax policy consideration that countries should consider before entering in a tax treaty with another country.

The OECD notes that the conclusions under the above actions will take the form of changes in the OECD MC. Also in the report is noted that the countries have committed to ensure a minimum level of protection against treaty abuse and treaty shopping.⁵⁶

3.2 Preventing the granting of treaty benefits in inappropriate circumstances

With regard to the first part of the work under action 6 concerning the methods to prevent granting of benefits in inappropriate circumstances, the report distinguishes between two types of cases:⁵⁷

- 1- Cases where the taxpayers circumvent domestic tax provisions by using treaty benefits.
- 2- Cases where the taxpayers circumvents the limitations of the tax treaty itself

According to the final Report, the first type involves situations where a person relies on the treaty benefits to circumvent domestic provisions. Regarding these cases the report proposes to clarify the current commentary on Article 1 of the OECD MC on the interaction between the domestic anti-avoidance rules and the tax treaties. The report also proposes a new article 1(3) in the OECD MC by including a “saving clause” which is based on the saving clause of the US tax treaty model. The incorporation of this clause in the OECD MC will preserve the application of the domestic anti –avoidance rules and effectively solve the conflicts between the domestic anti-avoidance rules and tax treaties provisions.⁵⁸

⁵⁴ OECD, Public Discussion Draft : Follow up Work on BEPS action 6 : Preventing Treaty Abuse (OECD 2014) ; Revised Discussion Draft: BEPS action 6 : Preventing Treaty Abuse (OECD 2015)

⁵⁵ OECD, “BEPS Action 6 Final Report” (n 3), para. 3

⁵⁶ OECD, “BEPS Action 6 Final Report” (n 3), para. 4-5, p.13

⁵⁷ Ibid, para. 15, p.17

⁵⁸ Ibid, p. 78-90

Regarding the second type of treaty abuse, cases as treaty shopping and rule shopping can be identified.⁵⁹ As also defined in chapter 2 of the paper “treaty shopping” concern situations where a person who is not entitled to the benefit of a treaty by using another taxpayer obtains these benefits which were not directly to him. Instead, “rule shopping” concern situations where a person is entitled to the benefits of the tax treaty and by means of certain arrangements he benefits from the most favorable provisions of that treaty.⁶⁰

According to the Report, the OECD recommended three actions in order to tackle treaty abuse under type 2:⁶¹

- 1- The title and preamble should have a clear statement that the purpose of the tax treaties is not intended to generate opportunities for treaty abuse.
- 2- The incorporation of a limitation on Benefits (LOB) clause as a specific anti-abuse rule in the OECD MC.
- 3- Also the incorporation of a general anti-abuse rule “GAAR” in order to address other forms of treaty shopping situations that the Lob would not cover. The GAAR would prevent the use of the treaty benefits by testing the principal purposes of the transactions or arrangements.

3.2.1 The LOB clause

One of the proposed recommendations of the report is to include in the OECD MC a specific anti-abuse rule as the Limitation on benefits “LOB” clause in order to disallow the treaty benefits in abusive practice situations. This approach is well-known in the international arena and it is present in the US tax treaty model and in some of the India and Japan treaties.⁶²

However, it is not unknown for the OECD either, as it is present in the paragraph 20 of the current OECD Commentary 2014 on Article 1. In this context, the OECD under action 6 proposes to transpose the LOB clause from the Commentary to the OECD MC.⁶³

Nevertheless, the final report does not present a “final” LOB and classifies it at the further work to be done. The reason is that the US has introduced a new LOB provision in May 2015 and it was delivered for public comments which would be sent on 15 September 2015. According to the OECD the final version of the LOB clause will be present in the first part of 2016.⁶⁴

⁵⁹ Ibid, para. 16, p.17

⁶⁰ Luc 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 (n 36), p.5

⁶¹ OECD, “BEPS Action 6 Final Report” (n 3), para. 19, p. 18

⁶² Ibid

⁶³ OECD, Commentaries on the Articles of the Model Tax Convention, para. 20, p. 65

⁶⁴ OECD, “BEPS Action 6 Final Report” (n 3), p. 14

The draft as it stands, presented a LOB clause which would only grant treaty benefits to taxpayers that, in addition of being residents have to be “qualified residents”. In order to be a “qualified resident” the taxpayer has to fulfill numerous specific conditions as laid down in paragraph 2: ⁶⁵

- a) An individual;
- b) Contracting states or its political subdivisions
- c) Publicly traded entities and companies “ stock exchange test”
- d) Charities and pension funds
- e) Entities that fulfill certain ownership criteria “ownership test”
- f) Certain collective investment vehicles (CIV)

However, if a resident will fail to fulfill the above requirements, he can still have access to treaty benefits under the paragraphs 3, 4 or 5 of the provision. ⁶⁶Specifically,

- Paragraph 3, lays down an “activity test” with respect to a specific item of income. The resident needs to be engaged with the active conduct of a business in the residence state. Although the test would not prevent all the types of treaty shopping as the ones through conduits arrangements. As the OECD also noted that the LOB clause would need to be supplemented by a general anti-abuse rule as the PPT. Further, the test is complex and needs to be examined each time that the incomes are gained.
- Paragraph 4, known as the “derivative benefits clause” allows to certain entities owned by residents of other states to obtain treaty benefits which they would have obtained also if they had invested directly.
- Paragraph 5, contains a “discretionary relief clause” which gives the possibility of granting the treaty benefits to “non-qualified residents” upon a request from the resident taxpayer

Because of its numerous tests, the LOB clause offers legal certainty in granting treaty protection as is not an “automatic” clause. However, being composed from series of tests the LOB clause would result in a complex provision for the tax authorities to apply. As the OECD admits in the Report: *“The administrative capacity of some countries might prevent them from applying certain detailed treaty rules and might require them to opt for more general anti-abuse provisions”*⁶⁷

⁶⁵ OECD, “BEPS Action 6 Final Report” (n 3), p. 21

⁶⁶ Ibid

⁶⁷ OECD, “BEPS Action 6 Final Report” (n 3),para. 6, p.14

3.2.2 The PPT rule

In order to address other forms of treaty shopping situations that the LOB clause would not cover OECD recommended the incorporation of a general anti-abuse rule. The GAAR would prevent the use of the treaty benefits by testing the principal purposes of the transactions or arrangements.

In the final report on BEPS action 6, the OECD has proposed the following wording for the PPT:

“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.”⁶⁸

According to the OECD the PPT rule reflects the general principle in the paragraph 9.5 of the Current Commentary to Article 1 of OECD MC.⁶⁹ In this context, there will only be a transfer of the PPT rule from the Commentary to the OECD MC. However, authors De Broe and Luts submitted that there is not a mere migration, but the OECD have lowered the anti- abuse threshold to deny granting the treaty benefits.⁷⁰

The requirements are made clear in the paragraph 12 of the Commentary on the PPT rule which states that:

“Obtaining the benefit under the tax convention need not be the sole or dominant purpose of the arrangement or transaction. It is sufficient that at least one of the principal purposes was to obtain the benefit”⁷¹

Although a transaction or arrangement can have various principal purposes not related to treaty benefits it will still fall under the PPT rule if also the obtaining of treaty benefits is one of the principal purposes.

As submitted in the second chapter of the paper, tax treaties aim is to facilitate cross-border transactions. Thus, some of the cross-border transactions or arrangements would not occur if no treaty would exist between the different jurisdictions. In this context, an arrangement would always have as one of the purposes the achievement of treaty benefits. Regarding this issue, the OECD did not provide a proper guidance for tax authorities regarding the application of PPT

⁶⁸ OECD, “BEPS Action 6 Final Report” (n 3), p. 55

⁶⁹ Ibid, para.1, p.55

⁷⁰ Luc De Broe and Joris Luts, BEPS action 6: Tax Treaty Abuse (n 44) p. 131

⁷¹ OECD, “BEPS Action 6 Final Report” (n 3),para.12, p.58

rule and how to distinguish between the principal and other purposes or between various principal purposes.⁷²

Another issue regarding the proposed GAAR is that burden of proof is shifted to the taxpayers. The paragraph 10 of the Commentary on the PPT rule states that:

*“It is not necessary to find conclusive proof of the intent of a person concerned with an arrangement or transaction, but it must be reasonable to conclude, after an objective analysis of the relevant facts and circumstances, that one of the principal purposes of the arrangement or transaction was to obtain the benefits of the tax convention”*⁷³

By analyzing the wording of the above paragraph, the tax authorities are still obliged to proof that there is a presence of the subjective element but not obliged to “*find conclusive proof*” that the purpose of obtaining treaty benefits was one of the principal purposes. This means that the threshold is set low for the tax authorities and it suffices to “*reasonable to conclude*” that such purposes where present.⁷⁴

However, the taxpayers cannot prevent the application of the PPT rule by only justifying that its arrangements or transactions were inspired also by other non –tax motives. Therefore, it is the taxpayer that carries the “burden of proof” of demonstrating that the benefit obtained in these circumstances is in accordance with the object and purpose of the relevant provisions of a certain Convention.⁷⁵

The legal consequence of the PPT is that “a benefit under this Convention shall be denied”.⁷⁶ In this context the rule’s aim is to counter the abuse of a particular tax treaty. The scope of the “benefits shall be denied” is not explained by the OECD in the final report which makes it unclear how it will interpreted by the national authorities. It is unclear if the consequences will be a total deny of the treaty benefits or will be denied in the respect of the part deemed to be abusive.

The relationship of the PPT rule with the LOB clause

The PPT rule applies “*Notwithstanding the other provisions of this Convention*”⁷⁷. The paragraph 3 of the Commentary on the PPT states that:

“The provision of paragraph 7 supplements and does not restrict in any way the scope or application of the provisions of paragraphs 1 to 6 (the limitation-on-benefits rule): a benefit

⁷² Luc De Broe and Joris Luts, BEPS action 6: Tax Treaty Abuse (n 44), p.132

⁷³ OECD, “BEPS Action 6 Final Report” (n 3),para.10,p.57

⁷⁴ Erik Pinetz, Final Report on Action 6 of the OECD/G20 Base Erosion and Profit Shifting Initiative : Prevention of Treaty Abuse, (2016), Bulletin for International Taxation , IBFD, p.113

⁷⁵ Carlos Palao Taboada, OECD Base Erosion and Profit Shifting Action 6 : The General Anti-Abuse Rule, (2016), Bulletin for International Taxation , IBFD, p.602

⁷⁶ OECD, “BEPS Action 6 Final Report” (n 3) ,p.64

⁷⁷OECD, “BEPS Action 6 Final Report” (n 3) ,p.55

that is denied in accordance with these paragraphs is not a “benefit under the Convention” that paragraph 7 would also deny.”⁷⁸

In this context, it is not sufficient for a taxpayer to pass the LOB clause tests and be a “qualified resident” but it has also to fulfill the requirements under the PPT rule in order to obtain the treaty benefits.

The authors De Broe and Luts, criticized the OECD’s proposal on the grounds of the principle “*lex specialis derogat legi generali*”. The authors submitted that once an arrangement or transaction pass the SAARs as the LOB clause, the PPT should only apply to the situations which are outside the scope of the SAARs. However, relying on the PPT wording it can be noted that it is a self –standing rule and can be applied although a transaction or arrangement has passed the treaty based SAARs.⁷⁹

3.2.3 The title and preamble amendment

The second part of the final report of the BEPS action 6 is to “*clarify that tax treaties are not intended to be used to generate double non-taxation*”. In order to achieve this aim OECD recommended an amendment of the title and preamble of the OECD MC. The proposed title of the OECD MC is as following:

“Convention between State A and State B for the elimination of double taxation with respect to taxes on income and on capital and prevention of tax evasion and avoidance”⁸⁰

It seems that base erosion is equal with tax avoidance in the title above. The changed in the title makes tax avoidance as one of the objectives of the OECD MC.⁸¹

Regarding the preamble of the OECD MC the OECD proposed to clearly express that the contracting States had entered into a tax treaty agreement with the intention to eliminate double taxation on income and capital taxes without creating opportunities for double non-taxation or a reduced taxation through tax avoidance and evasion.⁸²

However, the OECD MC only allocates taxing right under the provision 6-22 and does not interfere with the states sovereignty and right to tax. In this context, under these provisions the double non-taxation is not an objective of the OECD MC. Also it is important to note that although a taxpayer’s situation could result in double non- taxation cannot be claimed that the

⁷⁸ Ibid, para.3,p.55

⁷⁹ Luc De Broe and Joris Luts, BEPS action 6: Tax Treaty Abuse (n.44), p.133

⁸⁰ OECD, “BEPS Action 6 Final Report” (n 3) , para.72, p.91

⁸¹ Frans Vanistendael, “Is Tax Avoidance the Same Thing under the OECD Base Erosion and Profit Shifting Action Plan, (n 12), p. 169

⁸² OECD, “BEPS Action 6 Final Report” (n 3) ,para.72, p.91

benefit has been obtained in an abusive way and not in line with the purpose of the provisions.
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Even though, national courts can interpret the provision of the tax treaties under the light of the objectives of the amendment OECD MC, based in the article 31 (1) of the VCTL: *“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”*.⁸⁴

In addition, in the future treaties where the anti-abuse rules proposed in action 6 will be implemented the object and the purpose of the treaty will be materialized in the operating provisions. Nevertheless, the treaty objectives and purpose is only one of the elements that the interpreters have to take into consideration when interpreting the treaty provisions. Therefore, the general purpose of the treaty cannot override the substantive treaty provisions.⁸⁵

Ultimately, it is important that the tax authorities prove that the treaty is being abuse and not justifying their interpretation only under the grounds of the objective and purpose of the tax treaties is to prevent tax avoidance.⁸⁶

4. BEPS Action 6 in the light of EU law - Treaty Abuse

4.1 The concept of tax avoidance under the BEPS action 6 and EU Law

Under the Final Report on action 6, it is clear that the objective of the OECD proposals is the protection of the national tax base from erosion and profit shifting.⁸⁷ To achieve this objective the OECD recommendations cover not only situations of tax evasion and tax avoidance but also structures of aggressive tax planning where the taxpayer’s activities are within the bounds of the law.⁸⁸

In this context, the OECD purpose to tackle these situations “improper use of tax treaties” is to avoid double non –taxation or a reduced taxation at global level. This purpose is clearly shown with the proposal on the amendment of the title and the preamble of the treaties.⁸⁹

These proposed changes in the objectives of the tax treaties, fully fits with the wording of the PPT rule. In other words, although taxpayer’s arrangements and transactions will have valid

⁸³ Luc De Broe and Joris Luts, BEPS action 6: Tax Treaty Abuse (n 44), p.142

⁸⁴ OECD, “BEPS Action 6 Final Report” (n 3), para.73, p. 92

⁸⁵ Erik Pinetz, Final Report on Action 6 of the OECD/G20 Base Erosion and Profit Shifting Initiative : Prevention of Treaty Abuse (n 74) , p. 119

⁸⁶ Luc De Broe and Joris Luts, BEPS action 6: Tax Treaty Abuse (n 44), p.144

⁸⁷ OECD, “BEPS Action 6 Final Report” (n 3), p.9

⁸⁸ Ibid

⁸⁹ Ibid, p.13

business purposes it would not suffice to claim treaty benefits, if one of the main purposes was benefiting from a more favorable tax treatment.⁹⁰

Under these proposals the use of the concept of tax avoidance differs from the one established under the EU Law. The difference could be seen in the objective the two branches of law have. The objective of the EU law is the establishment of the internal market by abolishing cross-border restriction, instead as mentioned above, the aim of BEPS project is the protection of the national tax base of the states.

Also the difference regarding the arrangements covered is evident under the CJEU case law, as the Court held in the *ICI* case:

“As regards the justification based on the risk of tax avoidance, suffice it to note that the legislation at issue in the main proceedings does not have the specific purpose of preventing wholly artificial arrangements, set up to circumvent United Kingdom tax legislation, from attracting tax benefits, but applies generally to all situations in which the majority of a group's subsidiaries are established, for whatever reason, outside the United Kingdom. However, the establishment of a company outside the United Kingdom does not, of itself, necessarily entail tax avoidance, since that company will in any event be subject to the tax legislation of the State of establishment.”⁹¹

As seen in the above Court ruling, the tax avoidance in direct taxation field under the EU law is linked to the wholly artificial arrangement concept.⁹²

The proposed actions under the BEPS action 6 involve changes in tax treaties provisions, which mean that if the rules will be implemented they become hard law and states have the duty to comply under the principles of international law laid down in the VCLT.⁹³

In the light of all above, it is clear that a conflict will give rise from the different notions of tax avoidance where the two branches of law will interact. Thus, the conflict will occur in the countries which are members of both European Union and the OECD. Countries which are not part of the EU internal market can freely arrange their domestic and international tax policies. Instead MS of EU are bound to respect EU law requirements under the fundamental freedoms.⁹⁴

Before analyzing the compatibility of the anti-abuse rules proposed by the BEPS action 6 with EU law, the duty of MS to comply with EU law will be discussed by firstly describing the relationship between tax treaties and EU law, secondly the restrictions of implementing treaty provisions under the fundamental freedoms, and lastly, the EU concept of abuse which would serve as a benchmark in the analyze of the compatibility.

⁹⁰ Ibid, p.58

⁹¹ Case C- 264/96, *ICI* (n 9) , para. 26

⁹² Case C- 196/04, *Cadbury Schweppes* (n 8), para. 55

⁹³ Article 26 of VCLT

⁹⁴ Case C- 270/83, *Avoir Fiscal*” (n 9), para.13

4.1.1 The relationship between Tax treaties and EU law

The Tax Treaties are the main source of international tax law in the area of direct taxation. Their relationship with EU law has often give rise to conflicts because of their different objective and approach. As the objective of tax treaties is to regulate the allocation of taxing powers between the contracting states, the EU law objective is establishing the single market by abolishing the cross-border restriction.⁹⁵

In the non-harmonized field of the direct taxation Member states of EU have exclusive competence in exercising their taxing policies. Also is their competence to enter in international agreements with the aim to eliminate double taxation. In the *Gilly* case the Court held:

*“Member States are competent to determine the criteria for taxation on income and wealth with a view to eliminating double taxation — by means, inter alia, of international agreements”.*⁹⁶

However, under the principle of “sincere cooperation”⁹⁷ such discretion must be exercised in consistency with the EU law. The CJEU has always held that:

*“Although direct taxation falls within their competence, the Member States must none the less exercise that competence consistently with Community law”.*⁹⁸

Thus, where a conflict between EU law and the provisions of a tax treaty will occur, the EU law will prevail. This was made clear by the CJEU in the *Avoir Fiscal* case in which it was stated:

*The rights conferred by Article 43 of the Treaty are unconditional and a Member State cannot make respect for them subject to the contents of an agreement concluded with another Member State.*⁹⁹

Regarding the need of the tax treaties provision to comply with EU Law, in the *Bouanich* case the CJEU held that:

*“Since the tax system under the Franco-Swedish agreement, as interpreted in the light of the commentaries on the OECD Model Tax Convention, forms part of the legal background to the main proceedings and has been presented as such by the national court, the Court of Justice must take it into account in order to give an interpretation of Community law that is relevant to the national court”*¹⁰⁰

⁹⁵ European Commission Workshop of Expert , EC Law and Tax Treaties, (2005), DOC (05) 2306

⁹⁶ Case C- Gilly v Directeur des services fiscaux du Bas-Rhin, [1998] ECR I-2793, para.24

⁹⁷ Article 4(3) of TEU

⁹⁸ Case C-374/04, ACT IV GLO (n 16), para. 36

⁹⁹ Case C- 270/83, “Avoir Fiscal” (n 9), para.26

¹⁰⁰ Case C-265/04, Margaretha Bouanich v Skatteverket, [2006] ECR I-923, para. 51

Therefore, the CJEU refers to the tax treaties as being part of the set of national rules which must comply with the EU law and cannot be source of discrimination or restriction. In this context, tax treaty's provisions must comply with EU law requirements on non-discrimination and the fundamental freedoms under the TFEU.

4.1.2 Anti-treaty shopping rules and the Fundamental Freedoms

With the increased phenomenon of treaty abuse and treaty shopping in the area of international tax planning the states have begin to include anti-abuse rules in their tax treaties. However, as mentioned in the section above, when MS exercise their taxing competences they have the duty to comply with EU law requirements.

As the treaty shopping activity involves cross-border activities, the taxpayer's treaty rights under the fundamental freedoms are activated. From the perspective of freedom of establishment a treaty shopper is a taxpayer who establishes an intermediary company in another MS in order to benefit from a more favorable tax treaty by exercising its freedom of establishment. Instead in the perspective of freedom of movement of capital, a treaty shopper is a taxpayer who indirectly invests through another MS entity in a company by exercising the freedom of movement of capital.¹⁰¹

A clear example of a corporate forum shopping is the *Centros*¹⁰² case where the tax planning strategy involved the establishment of a company with a little economic substance in UK with the aim to circumvent the Danish company rules. In the ruling the CJEU that:

*“ the fact that a national of a Member State who wishes to set up a company chooses to form in the Member States whose rules of company law seems to him the least restrictive and to set up branches in other Member States cannot, in itself, constitute an abuse of the right of establishment ”*¹⁰³

In this context, even though the established company had a little economic substance the taxpayer was still protected under the freedom of establishment.

The Anti-treaty shopping rules when applied will tend to disregard the intermediary entity or to recharacterize the payment of passive incomes as being directly made to the company. In the light of all above, in prima facie anti-treaty shopping rules could be seen as a restriction of the freedom of establishment and movement of capital. However, not every type of tax planning and business structures is protected under the EU law. Thus, the restriction could be justified under

¹⁰¹ Christiana HJI Panayi, The Compatibility of the OECD/G20 Base Erosion and Profit Shifting Proposals with EU law, (n 15) , p . 105-106

¹⁰² Case C- 212/97, Centros Ltd v Erhvervs-og Sel –skabsstyrelsen (n 10)

¹⁰³ Ibid, para. 20

overriding reason of public interest as the prevention of tax avoidance¹⁰⁴; it also must be proportional to the pursued objectives.¹⁰⁵

4.1.3 Tax Avoidance under EU law

Member States cannot apply anti-treaty shopping rules that restrict cross-border transactions, unless the restrictive provision would be justified under the accepted grounds of the CJEU settled case law. Usually, the risk of tax avoidance is presented by the MS before the Court as a ground for justification of the restrictive tax treatment. However, the Court has been reluctant in accepting this justification because the states tend to consider as abusive practices also the taxpayers transactions and arrangements that result in a lower tax burden.¹⁰⁶

One of the first cases where tax avoidance was forwarded as a justification ground is the *Avoir Fiscal*, where the court rejected completely the argument of prevention of tax avoidance of the French government by stating that: “*The risk of tax avoidance cannot be relied upon in this context. Article 52 of the EEC Treaty does not permit any derogation from the fundamental principle of freedom of establishment on such a ground.*”¹⁰⁷

This case clearly shows that the CJEU does not accept wide anti avoidance provisions, instead, requires clear provision focused only in abusive situations. For the CJEU the taxpayer will be engaged in abusive practices only if the reduction of the tax burden is a result of “wholly artificial arrangement”. The concept of tax abuse in EU law has developed from the *Avoir Fiscal* case to the *Cadbury Schweppes*¹⁰⁸ which is known also as the leading case in the direct taxation area.

The *Cadbury Schweppes* case, concerns a UK parent company which established two subsidiaries in Ireland. From the UK perspective the company established the subsidiaries with the aim to avoid taxes because of the low tax jurisdiction in Ireland. In this context, the company was subject of the British CFC rules for its two Irish subsidiaries. However from the CJEU perspective the parent company exercised the freedom of establishment by establishing two subsidiaries in another MS with the result in a lower tax burden. In this context the CJEU held that:

¹⁰⁴ See e.g Case C- 264/96, ICI (n 9) , para. 26, Case C- 9/02 Hughes de Lasteyrie du Saillant [2004] ECR I—2409, para. 35, and Case C- 324/00 Lankhorst – Høhorst, [2002] ECR I-11779, para. 37

¹⁰⁵ See e.g Case C- Gebhard, [1995], ECR I -4165

¹⁰⁶ Frans Vanistendael, “Is Tax Avoidance the Same Thing under the OECD Base Erosion and Profit Shifting Action Plan, National Tax Law and EU Law”, (n 12), p. 166

¹⁰⁷ Case C- 270/83, “Avoir Fiscal” (n 9), para.25

¹⁰⁸ Case C- 196/04, Cadbury Schweppes (n 8)

“The fact that a Community national, whether a natural or a legal person, sought to profit from tax advantages in force in a Member State other than his State of residence cannot in itself deprive him of the right to rely on the provisions of the Treaty”¹⁰⁹

The CJEU found that the applied CFC rules restricted the freedom of establishment by resulting in a disadvantageous treatment of the concern company compared with the parent companies with domestic subsidiaries. The British government in order to justify the restriction put forward the tax avoidance as an overriding reason in the public interest. Regarding the justification ground the Court held:

“As to freedom of establishment, the Court has already held that the fact that the company was established in a Member State for the purpose of benefiting from more favorable legislation does not in itself suffice to constitute abuse of that freedom”¹¹⁰

And

“It follows that, in order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory.”¹¹¹

The Cadbury Schweppes judgment is very important because it gives a deeper analyzes of the concept “wholly artificial arrangements”. Also in the judgment the Court made the distinction between acceptable tax mitigation and tax avoidance by being supported by its settled case law.¹¹²

The position of the CJEU in the above ruling is very clear regarding the fundamental freedoms. The Court confirmed that tax planning strategies made in order to benefit from the differences in tax jurisdictions such as “Forum shopping” and “treaty shopping” are not abusive, until the taxpayer has exercised effectively the fundamental freedoms under the TFEU.¹¹³

In the light of all above, the concept of abuse set out by the CJEU case law constitutes an important norm when denying treaty benefits. Thus, Member States of both the OECD and the EU have to be careful in the wording of the anti-treaty shopping provision which could hinder the rights conferred by the EU primary law.

¹⁰⁹ Case C- 196/04, Cadbury Schweppes (n 8), para. 36

¹¹⁰ Ibid para. 37,

¹¹¹ Ibid, para. 55

¹¹² Tom O’Shea ,The UK’s CFC rules and the freedom of establishment: Cadbury Schweppes plc and its IFSC subsidiaries - tax avoidance or tax mitigation?, EC Tax Review 2007/1, p.21

¹¹³ Michael Lang ,Union Law and OECD Model Concepts: What can we learn from Comparison, Guglielmo Maisto (ed), Departures from the OECD Model and Commentaries: Reservations, observations and positions in EU law and tax treaties, (Vol. 11 IBFD 2014), chapter 4,p .73

4.2 LOB clause and possible issues from an EU perspective

The compatibility of the LOB clause with EU law is a topic of intense academic debate which has been discussed in the past decade.¹¹⁴ Therefore, the OECD proposal to include a LOB clause in the Member State's tax treaties revives these discussions.

The LOB clause denies the treaty benefits to taxpayers that would not pass its tests, therefore treating them in a more disadvantageous way than others. Hence, from the fundamental freedoms perspective the LOB clause treats differently the “qualified resident” with the “non-qualified residents” and creates a burden on cross-border activities.¹¹⁵

However, the different treatment of the taxpayers under the LOB clause could be justified if the taxpayers would not be in a comparable situation or under the grounds of justification accepted by the CJEU. Also the restriction if justified has to be proportional to the pursued objectives.¹¹⁶

Regarding the comparability, the Court has already dealt with the LOB clauses in several cases. Firstly, in its *Open Skies* decision¹¹⁷, where the Court comparability test was based on the different treatment of the nationals of MS, found that the bilateral agreements between the United States and some Member States contained a provision which allowed the US to discriminate companies owned by nationals of MS other than the contracting ones. In this context, the Court stated

*“It follows that the clause on the ownership and control of airlines is contrary to Article 52 of the Treaty”*¹¹⁸

The provision based on the nationality in the *Open Skies* cases has similarities with the ownership test in the proposed LOB clause; however, the later contains residence requirements.

After some years later, the CJEU conversely ruled in the *ACT IV GLO*¹¹⁹ where the LOB clause was based on the residence as a requirement. The LOB clause in the UK –Netherland DTC aim was to limit the granting of the treaty benefits to non-qualifying residents. In its

¹¹⁴ See, e.g G.W. Kofler, European Taxation under an “Open Sky”: LOB Clauses in Tax Treaties Benefits between the US and the EU Member States, (Tax Notes INTL 2004), p.45; and Christian HJI Panayi, Open skies for EC Tax? (British Tax review 3, 2003), p. 189

¹¹⁵ F.Debelva,D. Scornos, J. Van den Berghen & P. Van Brabant, LOB Clauses and EU-Law Compatibility: A debate Revived by BEPS, EC Tax Review 2015/3, (Kluwer Law international, 2015), p. 134-135

¹¹⁶ Ibid

¹¹⁷ Joined cases: C-466/98 Commission of the European Communities v. United Kingdom of Great Britain and Northern Ireland; C-467/98, Commission of the European Communities v. Kingdom of Denmark; C-468/98 Commission of the European Communities v. Kingdom of Sweden; C-469/98 Commission of the European Communities v. République de Finlande; C-471-98 Commission of the European Communities v. Kingdom of Belgium; C- 472/98 Commission of the European Communities v. Grand Duchy of Luxembourg; C-475/98 Commission of the European Communities v. Republic of Austria; C-476/98 Commission of the European Communities v. Federal Republic of Germany ‘Open Skies cases’, [2002],

¹¹⁸ Case C -476/98 - Commission v Germany, (“Open Skies”), [2002] ECR I-9855, para. 156

¹¹⁹ Case C-374/04, “ACT IV GLO” (n 16)

decision the CJEU referred to the “D” case¹²⁰ by stating that treaty benefits do not necessarily have to be transposed to residents of other MS than the ones of the contracting states.¹²¹ According to the Court LOB clauses are considered as “*an inherent consequence of bilateral double taxation conventions*’.¹²²

Based on this judgment, the Court did not find comparability and non-discrimination between resident and non-residents. As the Author Dourado suggested, the proposed LOB clause will be compatible with EU case law.¹²³

However, it is important to note that in November 2015 the EU Commission asked Netherlands to amend its LOB clause involved in the bilateral tax treaty with Japan. The Commission argues that a MS cannot include a provision which would treat less favorable shareholders residents of another MS than residents of the contracting states. Also cannot grant a more beneficial treatment to companies which are traded in the stock market of the contracting states than for the companies traded in other MS stock markets. The Commission arguments were based on the CJEU case law as the *Gottardo*¹²⁴ and the *Open skies* cases.¹²⁵

As the author J. Calejo Guerra notes, the CJEU did not yet settle the issue of the compatibility of the residence requirements under the LOB clause with the fundamental freedoms, even though the CJEU decisions in the *Open Skies* and *ACT IV GLO* cases.¹²⁶

However, for academic purposes more theoretical discussions may be raised regarding the proposed LOB clause. By presuming that the LOB clause could give rise to discrimination among qualified and non-qualified taxpayers under the EU law yet it could be justified under overriding reason of public interest as the prevention of tax avoidance.¹²⁷

As the propose LOB clause is a specific anti-abuse rule (SAAR), in order to be compatible with the EU law and its general principle of abuse, it has to target only the “wholly artificial arrangements” and involve “a case by case analysis”.¹²⁸

¹²⁰ Case C-376/03, *D v Inspecteur van de Belastingdienst*, [2005] IECR 5821

¹²¹ Case C-374/04, “ACT IV GLO” (n 16), para.94

¹²² *Ibid*, para. 91

¹²³ Ana Paula Dourado, *Aggressive Tax Planning in EU Law and in the Light of BEPS: The EC Recommendation on Aggressive Tax Planning and BEPS Actions 2 and 6*, Intertax, Volume 43/1 (Kluwer Law International 2015), p.55

¹²⁴ Case C- 55/00, *Elide Gottardo v Istituto nazionale della previdenza sociale*, [2002] ECR I-413

¹²⁵ European Commission Press release, November infringements package: key decisions, 19 November 2015

¹²⁶ J. Calejo Guerra, *Limitation on Benefits Clauses and EU Law*, 51 *Eur. Taxn.* 2/3, (Journals IBFD 2011)

¹²⁷ See, e.g Case C-9/02, *Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie*, [2004] ECR I-2409, para. 50 and Case C-324/00, *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt*, [2002] ECRI-11779 , para.37

¹²⁸ F.Debelva,D. Scornos, J. Van den Berghen & P. Van Braband, *LOB Clauses and EU-Law Compatiblity: A debate Revived by BEPS* (n 115), p. 139

Under the BEPS action 6, the OECD proposed also to include in the LOB clause a Derivative Benefit Test as a possible solution for the LOB compatibility with EU law.¹²⁹ The provision allows investors (3rd state) to claim the treaty benefits if they are “equivalent beneficiaries”¹³⁰ that would have been also entitled to if they had invested directly in the source state. This clause also contains two tests as the (1) ownership test and (2) base erosion test. Additionally, with respect to withholding taxes rates that they would be entitled to under the convention (if directly invested) are at least as low as the rates applicable with the claimed treaty.¹³¹

However, there seem to be various issues related to the EU law and the proposed test. Firstly, although the derivative benefit test will reduce the discrimination it does not mean that the compatibility with EU law issue is solved; secondly, the test’s aim could go further than targeting only the wholly artificial arrangements because the investors resident of a 3rd state are still subject to additional requirements¹³².

4. 3 The PPT rule compatibility with Primary EU Law

The PPT rule proposed in the final report, according to its wording applies when one of the principal purposes was achieving a tax treaty benefit.¹³³ A similar wording is used also by the EU Commission in its Recommendation regarding treaty abuse, released with Anti –Avoidance package on 28 January 2016.

The EU Commission recommended MS to include a GAAR in their tax treaties which has to be worded as following:

“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 it reflects a genuine economic activity or that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention”¹³⁴

¹²⁹F.Debelva,D. Scornos, J. Van den Berghen & P. Van Braband, LOB Clauses and EU-Law Compatibility: A debate Revived by BEPS (n 115), p. 139

¹³⁰ OECD, Proposed Commentary to LOB ,“BEPS Action 6 Final Report” (n 3), para.6

¹³¹ OECD, Proposed Commentary to LOB, “BEPS Action 6 Final Report” (n 3), para.59-60

¹³² F.Debelva,D. Scornos, J. Van den Berghen & P. Van Braband, LOB Clauses and EU-Law Compatibility: A debate Revived by BEPS (n 115), 140-141

¹³³ OECD, “BEPS Action 6 Final Report” (n 3), p.58

¹³⁴ Commission Recommendation ‘on the implementation of measures against tax treaty abuse’ (n 13), p.2 of the recommendation

The EU Commission approach in the recommended GAAR is not a new one; a similar GAAR is included in the amended Parent-Subsidiary Directive¹³⁵.

The general anti-avoidance rule included in the PSD¹³⁶, reads as follows:

“Article 1:

(2) Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.

3) For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.”

Even though the wording of the EU Commission GAAR and PSD GAAR refer to “one of the main/principal purposes”, its application is limited to arrangements without a valid commercial reason. In this context, although taxpayer’s arrangements have as one of the main/principal purposes obtaining a tax advantage, till they have a genuine economic substance the GAARs would not be applied.

In the OECD proposed PPT rule there is no such provision. The PPT rule does not refer to “artificially” or to “normal commercial operations”. Although one of the examples in the paragraph 8 of the Commentary on the PPT rule refers to “valid commercial reasons”, it does not give any proper definition.¹³⁷

The PSD amended and the EU Commission initiative can be seen as a development of the EU abuse concept settled by the CJEU court. However, the development occurs at the level of secondary EU law and the CJEU did not have yet the possibility to rule regarding the new GAAR in the PSD.

It seems like the GAAR in the PSD could be used as a standard for the PPT rule to be introduced in the Member States tax treaties. However, it is important to mention that since the CJEU decision in the *Kofoed* case,¹³⁸ it is generally understood that a MS cannot rely directly to the anti-abuse provision in the EU directives regarding direct tax matters in order to counter directive shopping.

¹³⁵ Council Directive (EU) 2015/121 of 27 January 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, [2015], OJ L21/1

¹³⁶ Council Directive (EU) 2015/121 of 27 January 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, [2015], OJ L21/1

¹³⁷ OECD, Proposed Commentary on the PPT rule, “BEPS Action 6 Final Report” (n 3), para. 8

¹³⁸ Case C- 321/05, Hans Markus Kofoed v Skatteministeriet, [2007] ECR I-5795

Consequently MS to counter treaty or directive shopping have to introduce domestic or treaty based anti-abuse rules. However, CJEU case law clearly indicates that MS have to draft them in way that does not create a restriction of the fundamental freedoms under the EU law. In this context, the anti-abuse rules have to be in line with the abuse concept in the EU law and applied only to “wholly artificial arrangements”.¹³⁹

Since the PPT rule applies in every situation where one of the main principles was achieving a treaty benefit and does not consider the genuine substance of the transactions by not targeting only the “wholly artificial arrangements”, it would not be in line with EU law requirements.¹⁴⁰

Therefore, Member States need to consider the EU law implications which in many situations limit the leeway for introducing such anti-abuse rules against structures set up with the purpose to minimize source state taxation.

4.4 Double non –taxation as a justification ground

The other main change proposed by the OECD, as mentioned in the section 4.3, is to insert in the preamble of the tax treaties a statement which would clarify that intention of the treaties is to not create possibilities for double non-taxation or for reduced taxation through abusive practices.¹⁴¹

The issue of double non-taxation was also raised by the European Commission in a public consultation on 29 February 2012, and in the same year the EU Commission published the recommendation on aggressive tax planning where was proposed the subject –to –tax clause to be included in the MS treaties.¹⁴²

Although EU Commission¹⁴³ and the OECD¹⁴⁴ consider double non-taxation as unfair, it is not incompatible with EU law.

From the CJEU settled case law, double taxation or non-double taxation caused by the exercise of the tax competences of different MS is not incompatible with EU law. In the rulings in *Kerckhaert and Morres* and *Damseaux* cases the CJEU stated:

*“Disadvantages which could arise from the parallel exercise of tax competences by different Member States; to the extent that such an exercise is not discriminatory, do not constitute restrictions prohibited by the EC Treaty”.*¹⁴⁵

¹³⁹ Case C- 196/04, Cadbury Schweppes (n 8), para. 55

¹⁴⁰ Ibid

¹⁴¹ OECD, “BEPS Action 6 Final Report” (n 3), p.91

¹⁴² Commission Recommendation ‘on aggressive tax planning’, C(2012) 8806 final, para.3 of the recommendation, p. 3

¹⁴³ Ibid

¹⁴⁴ OECD, “BEPS Action 6 Final Report” (n 3),

In this context, the justification of restrictive measures under the grounds of double non-taxation may not be accepted by the CJEU. However, if the argumentation would be based under the justification of tax avoidance and the transaction will be wholly artificial then the restrictive measures could be justified if proportional.

5. CONCLUSION AND FINAL REMARKS

Although the globalization has given the possibility to taxpayers to structure their business in the most efficient way, the differences in tax jurisdictions of the states limited their cross-border activities. For this reason, countries concluded bilateral tax treaties with the aim to avoid double taxation and facilitate the trade and investments in cross-border activities. Most of the treaties are based on the OECD MC but still they have differences with each other. Thus, some of the treaties grant more favorable treatment than others, by creating opportunities of tax planning. Taxpayers have seen the tax treaties not only as an instrument to avoid double taxation but also as a possibility to avoid taxes. One of the strategies used is the “Treaty shopping” where the taxpayer shops the most appropriate tax treaty in order to achieve the lowest possible tax burden.¹⁴⁶

Even though, international tax planning is treated as a legitimate practice, since the OECD Commentary 1977 some forms were classified as improper use of tax treaties. Being aware of the risk of treaty abuse, countries and the OECD have been involved in finding ways to properly address this issue.¹⁴⁷

In July 2013, the issue of improper use of tax treaties has been introduced as one of the main objectives of the OECD BEPS project, which means that the actions taken by the states and the changes in the OECD Commentary of 2003 did not prevent effectively treaty abuse.¹⁴⁸

Specifically, the improper use of tax treaties is covered by BEPS action 6 which provides countries with actions to be taken in order to prevent the granting of tax treaty benefits in inappropriate circumstances. The final report on BEPS action 6, recommends three actions to be taken in order to prevent treaty abuse.¹⁴⁹

The first recommendation is the inclusion of a LOB clause (draft) in the OECD MC. The clause would only grant treaty benefits to “qualified taxpayers” whose fulfill the numerous specific tests. Being composed from series of tests the LOB is not an “automatic” clause which would

¹⁴⁵Case C-128/08, Jacques Damseaux v. Etat Belge, [2009] ECR I-6823; and Case C-513/04, Mark Kerckhaert and Bernadette Morres v Belgische Staat, [2006] ECR I-1096, para. 19, 20 and 24 ;

¹⁴⁶ Christiana HJI Panayi, Double Taxation, Tax Treaties, Treaty-Shopping And The European Community (n 27) p 34-37

¹⁴⁷ Ibid, p. 43-44

¹⁴⁸ Luc De Broe and Joris Luts, BEPS action 6: Tax Treaty Abuse, (n 44), p. 124

¹⁴⁹ OECD, BEPS Action 6 Final Report” (n 3), p. 9

directly deny the treaty protection. However, the complexity of this provision and its application by the tax authorities could lead to legal uncertainty.¹⁵⁰

Second recommendation involves a general anti-avoidance rules as the Principal Purpose Test (PPT) which could be included alone or together with the LOB clause in the OECD MC. The PPT rule would apply in situation where one of the principal purposes of the taxpayer transactions or arrangements is achieving a tax/treaty benefit. However, the OECD did not offer guidance for the tax authorities to properly distinguish between the principal purpose and the ancillary purposes. Also in the PPT rule the burden of proof is shifted to the taxpayers. The vague wording of the PPT and the missing guide for the tax authorities would lead also to legal uncertainty.¹⁵¹

The third recommendation regards the amendment of the title and preamble of the OECD MC, which will clarify that the tax treaties are not intended to be used to generate double taxation and that one of the purposes of the treaties will be also the prevention of tax evasion and avoidance. It seems that the OECD equals the base erosion with tax avoidance. However, the treaty objectives and purpose is only one of the elements that interpreters take into consideration when interpreting the specific treaty provisions. Thus, the general purpose of the tax treaty cannot override the substantive treaty provisions.¹⁵²

In addition of the issues of raised above regarding the proposed OECD actions, another major issue is their implementation in the domestic law and tax treaties of MS of the EU.

In the EU, Member States still have the competences to design their tax legislation. Also is their competence to enter in international agreements with the aim to eliminate double taxation. However, under the principle of “sincere cooperation” these competences have to be exercised in line with the EU Law.

Thus, countries outside the EU internal market are free to implement in their tax treaties the proposed anti-abuse rules under the BEPS action 6. Instead MS of the EU, when implementing the treaty anti-abuse rules have to comply with the EU Fundamental Freedoms and also with the EU abuse concept.¹⁵³

¹⁵⁰ OECD, BEPS Action 6 Final Report” (n 3), p. 14

¹⁵¹ Erik Pinetz, Final Report on Action 6 of the OECD/G20 Base Erosion and Profit Shifting Initiative : Prevention of Treaty Abuse, (2016), Bulletin for International Taxation , IBFD, p.113

¹⁵² Luc De Broe and Joris Luts, BEPS action 6: Tax Treaty Abuse, (n 44), p. 144

¹⁵³ Christiana HJI Panayi, The Compatibility of the OECD/G20 Base Erosion and Profit Shifting Proposals with EU law (n 15) , p.109

In the perspective of the Fundamental Freedoms both anti-abuse rules, the LOB and the PPT rule, when applied will give rise to a restriction by denying the treaty protection to taxpayers exercising their rights conferred by the TFEU.¹⁵⁴

Regarding the LOB clause which distinguishes between the “qualified resident” and “non qualified resident”, the restriction could be justified by arguing that the taxpayers are not in a comparable situation. The argument could be supported by the CJEU judgment in the *ACT IV GLO*¹⁵⁵ case. However, with the EU Commission formal request addressed to Netherland on the amendment of the LOB clause included in the tax treaty with Japan and the inconsistency of the CJEU case law regarding the LOB clause it can be concluded that the compatibility of the residence requirements with the Fundamental Freedoms has not been settled yet.¹⁵⁶

In order to comply with the EU law the OECD proposed to include also a derivate test in the LOB clause which would allow the granting of the treaty benefits to “equivalent beneficiaries”. Although the proposed test would reduce the discrimination it does not mean that the compatibility of the residence requirements with the fundamental freedoms would be solved.¹⁵⁷

Nevertheless, by presuming that the LOB clause will give rise to discrimination yet it could be justified under the ground of public interest as the tax avoidance. However, under the settled case law the justification under the ground of tax avoidance is accepted only in the cases where the anti-abuse rules targeted “wholly artificial arrangements”. The Derivate test’s aim goes further than targeting the wholly artificial arrangements because the investors of the 3rd countries although with a genuine economic substance will still be subject to additional requirements which could restrict their freedoms.¹⁵⁸

The same justification ground could be used also to justify the PPT rule application. However, in order to be justified it has to target only the “wholly artificial arrangements”. Although the PPT wording could be seen as being in line with the GAAR included in the PSD and the GAAR in the EU Commission recommendation regarding the treaty abuse, it does not offer the possibility of non-application in situations where the arrangements and the transaction have a genuine economic substance. Thus, the PPT rules will apply in situation where one of the principal purposes is to achieve a treaty benefit without taking into consideration the genuine economic substance of the arrangements or the transactions.¹⁵⁹

¹⁵⁴ Christiana HJI Panayi, *The Compatibility of the OECD/G20 Base Erosion and Profit Shifting Proposals with EU law* (n 15) , p.109

¹⁵⁵ Case C-374/04, *ACT IV GLO*

¹⁵⁶ J. Calejo Guerra, *Limitation on Benefits Clauses and EU Law* (n 126)

¹⁵⁷ F.Debelva,D. Scornos, J. Van den Berghen & P. Van Brabant, *LOB Clauses and EU-Law Compatibility: A debate Revived by BEPS* (n 115), p. 139

¹⁵⁸ *Ibid*

¹⁵⁹ Luc De Broe and Joris Luts, *BEPS action 6: Tax Treaty Abuse*, (n 44), p. 131-133

Although, the similarities of the PPT rules with the anti-abuse rules found in the EU tax Directives, from the settled CJEU case law it is stated that MS cannot directly rely on the Directive provisions.¹⁶⁰

It would be very interesting to have a case under the CJEU scrutiny regarding the anti-abuse rule in the PSD. Would the CJEU accept anti –avoidance rules which target other than the “wholly artificial arrangements”?

However, the above question is entirely speculative. Based on the CJEU judgment in the Cadbury Schweppes it ensures that the fundamental freedoms prevail in circumstances beyond ‘wholly artificial arrangements’ when, there has been a proper exercise of the rights conferred by the TFEU.¹⁶¹ In this context, the PPT rule would not be in line with the “wholly artificial” concept settled by the CJEU.

Another thing to note regarding the proposed anti-abuse rules under the EU law is that they do not meet the requirements of legal certainty. In the *Itelcar*¹⁶² case, the court held that anti-abuse rules have to be sufficiently clear, precise and predictable in order to meet the requirement of the legal certainty.

In the light of all above, the OECD proposes far-reaching changes in the international principles. However, MS of EU have to carefully analyze these proposals because such actions could result in generating legal uncertainty and hinder or make less attractive the exercise of fundamental freedoms.¹⁶³

To conclude, the BEPS action 6 recommendations are not compatible with the EU law. MS of the EU when implementing and applying the proposed anti-abuse rules have to take into consideration the limits set by the CJEU case law regarding the anti –abuse rules.

¹⁶⁰ Case C- 321/05, Kofoed (n 138)

¹⁶¹ Case C- 196/04, Cadbury Schweppes (n 8), para. 55

¹⁶² Case C-282/12, Itelcar – Automóveis de Aluguer Lda v Fazenda Pública, [2013] ECRI-0000, para. 44

¹⁶³ Frans Vanistendael, “Is Tax Avoidance the Same Thing under the OECD Base Erosion and Profit Shifting Action Plan, National Tax Law and EU Law” (n 12), p.172

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