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## **BEPS Action 6 - An inclusion of anti-abuse measures in tax treaties to prevent the improper use of a tax treaty**

**Are the measures suggested in BEPS Action 6 necessary from a Swedish perspective?**

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# Summary

Tax treaties are an important tool for encouraging cross-border trade by eliminating judicial double taxation. But due to aggressive tax planning via tax treaties, contracting states may want to use domestic anti-avoidance provisions to hinder improper use of a tax treaty. The norm conflict between domestic law and tax treaties is solved differently depending on the constitutional law of a state. The use of domestic law can be justified if carried out in accordance with an interpretation of the object and purpose of the tax treaty provision. This interpretation can on the other hand be questioned according to the principle of *pacta sunt servanda*, and to determine that the object and purpose of the tax treaty is to prevent tax avoidance or evasion can be problematic.

Therefore the OECD and G20 project BEPS has addressed the issue of improper use or abuse of tax treaties and suggest anti-abuse measures to be included in the tax treaty. The improper use of tax treaties should according to BEPS Action 6 be addressed with a LOB, or a PPT included in tax treaties. There are several issues regarding the suggested measures, the broad formulation creating legal uncertainty regarding the PPT and the complexity of the LOB. The least extensive suggestion in Action 6 is changes to the title, the preamble and the Commentaries of the OECD Model Convention, clarifying that a purpose of tax treaties is not to facilitate tax avoidance or evasion. The measures are supposed to be included in a multilateral instrument directly changing all existing treaties. This would require all states to assign to the multilateral instrument which will be challenging. Further there might be constitutional restrictions hindering the implementation of Action 6, or existing anti-abuse rules making Action 6 unnecessary.

According to the current law in Sweden a tax treaty takes precedence over domestic law in a norm conflict. In cases of improper use of the tax treaty the Supreme Administrative Court has concluded that as long as there is no statement in the tax treaty expressing the intention of the contracting states, that domestic anti-avoidance rules cannot be used, the domestic rule can prevail over the tax treaty. The interpretation can be questioned according to international law. From a Swedish perspective the inclusion of an LOB and PPT in the tax treaties would be possible according to the constitution, not addressing the issue of EU law. The LOB or PTT are on the other hand according to the author not necessary. By an inclusion in the preamble that a purpose of the tax treaty is to prevent tax avoidance or evasion the interpretation of the Swedish Administrative Court would be in accordance with the object and purpose as stated in article 31 VCLT. The Swedish domestic Anti-Avoidance Act will therefore be sufficient to prevent improper use of a tax treaty.

# Abbreviation list

Action 6	Action 6 - Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
BEPS	Base Erosion Profit Shifting
CFC	Controlled Foreign Company
EU	European Union
GAAR	General Anti-Avoidance Rule
LOB	Limitations on Benefits
MNE	Multi National Enterprises
MC	Model Convention
OECD	Organisation for Economic Co-operation and Development
PPT	Principal Purpose Test
p.	page
SAAR	Special Anti-Avoidance Rule
The Commentaries	the Commentaries to the OECD Model Convention
VCLT	Vienna Convention on the Law of Treaties

# 1 Introduction

## 1.1 Background

A purpose of tax treaties is to, by eliminating judicial double taxation, encourage cross-border relationships to increase flow of capital and labour.<sup>1</sup> Through the tax treaty the contracting states allocate their right to tax and the tax treaty provides legal certainty for taxpayers when arranging their business. Although it has been accepted that taxpayers arrange their business to lower the tax burden,<sup>2</sup> aggressive tax planning by multinational companies (MNEs) is identified as a threat to state's tax bases. Tax treaties has become a tool for international aggressive tax planning, and the problem is that cross-border transactions can be arranged to reduce taxes by using the tax treaties in a way not intended.<sup>3</sup> This is referred to as abuse or improper use of the tax treaty.

Contracting states might therefore want to use their domestic legislation to prevent use of a tax treaty leading to benefits not intended by the provision in the tax treaty.<sup>4</sup> The use of domestic legislation to deny treaty benefits, which would otherwise be granted by the treaty, is prohibited according to international law and the fundamental principle of *pacta sunt servanda*.<sup>5</sup> How domestic anti-abuse rules can be used in a situation where the tax treaty is applicable is a controversial question subject to discussions by academics. Since 2003 the Commentaries to the OECD Model Convention (OECD MC) gives some guidance about the relationship between domestic anti-abuse rules and tax treaties, but the legal issues of the potential collision of norms still exists.

Due to states sovereignty, the conflict between domestic anti-avoidance provisions and tax treaties is solved differently depending on the constitutional law of the state. Ultimately it is a question of hierarchy of

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<sup>1</sup> OECD (2014), Model Tax Convention on Income and on Capital, p. 7; Gerzova. L. Popa. O. "Compatibility of Domestic Anti-avoidance Measures with Tax treaties" European Taxation - Special issue, September 2013, p. 420; Handledning för beskattning av inkomst vid 2013 års taxering, Skatteverket 2013, p. 83.

<sup>2</sup> De Broe. L. "International Tax Planning and Prevention of Abuse" Doctoral Series IBFD, Vol 14, 2008, p. 320.

<sup>3</sup> Van Weeghel. S. Arnold. B. J. "The relationship between tax treaties and domestic anti-abuse measures" in Tax treaties and Domestic law, IBFD international tax law series, vol. 2, 2006, p. 81.

<sup>4</sup> Michel. B. "Anti-avoidance and tax treaty override: pacts sunt servanta?" European Taxation – Special Issue, September, 2013, p. 414.

<sup>5</sup> Gerzova. L. Popa. O. "Compatibility of Domestic Anti-avoidance Measures with Tax treaties" p. 420.

norms and how the states implement international law and the interpretation of national courts.<sup>6</sup>

The wide-spread use of tax treaties constituting abusive practise is an issue addressed in the the Base Erosion and Profit Shifting (BEPS) project by OECD and the G20 countries. In the report “Action 6 - Preventing the Granting of Treaty Benefits in Inappropriate Circumstances” (Action 6) anti-abuse measures are suggested to be included in the tax treaties. The suggested measure is to include a Limitation on Benefits (LOB) clause in the tax treaties and a Principal Purpose Test (PPT) operating as a general anti-avoidance rule (GAAR) in the tax treaties. These measures are not mandatory and a minimum standard are suggested in form of a clear statement in the tax treaties that the intention of the contracting states is to prevent tax avoidance.

Action 6 recognises that the suggested measures need to be implemented in accordance with specificities of the individual state and the circumstances of the negotiation between the states entering into the tax treaty. This can for example be due to a state’s constitutional law or that a state has concerns regarding European Union (EU) law preventing them from implementing the exact wording of provisions suggested in the report. Furthermore domestic anti-abuse provisions can already be preventing abuse of treaties. To the extent domestic anti-avoidance provisions are in conformity with the principles in the Action 6, the LOB or PPT might not be necessary.<sup>7</sup>

The thesis will analyse the suggested measures and the implementation of BEPS in Sweden. The question is if the suggested measures are needed or would the measures lead to a complex international tax treaty system making it impossible for taxpayers to predict the consequence of their transactions.

## 1.2 Aim

The purpose of the thesis is to give an overview of the issues regarding the relationship between tax treaties and domestic law and the norm collision that might arise if a contracting state use domestic anti-avoidance provisions to prevent improper use of a tax treaty. The issue is addressed in BEPS Action 6 and the purpose is to describe the provisions suggested in the report.

The implementation of Action 6 and issues regarding the suggested implementation will be briefly analysed, since implementation is

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<sup>6</sup> Erasmus-Koen. M. Douma. S. “The legal status of the OECD-Commentaries – in search of the Holy grail of international law” Tax treaty monitor, Bullentin for International taxation, August 2007, p. 349.

<sup>7</sup> OECD (2015) “Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report” OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 14.

fundamental for the action plan to succeed. If Action 6 is hindered by constitutional restrictions or necessary due to existing anti-abuse rules will be analysed from a Swedish perspective.

### 1.3 Method and material

To reach the aim of the thesis the relationship between international law and internal law will be analysed. The relationship between the two legal sources depends on a state's constitutional law. A state can be monistic meaning that the tax treaties constitute domestic law when entered into by the state, or dualistic meaning that the state consider domestic law and international law as two separate legal sources. Therefore the tax treaties in a dualistic state need to be incorporated into domestic law.<sup>8</sup>

The method appropriate to establish the relationship between domestic and international law will be a traditional legal dogmatic research method. By the legal dogmatic method the aim is to determine the law as it stands today by national and international legislation, principles, case law and literature.<sup>9</sup> As regards international law the most relevant legal source will be the OECD MC and the Vienna Convention on the Law of treaties (VCLT). A question regarding the OECD MC is the legal value of the OECD MC Commentaries. The OECD MC Commentaries (the Commentaries) are so-called soft law, not having any legally binding effect on the contracting states. Although it has been argued that the Commentaries may produce legal effect through the tax treaties and general principles of law.<sup>10</sup> In most states the Commentaries are taken into consideration for the interpretation of the treaties.<sup>11</sup> The VCLT is a fundamental convention in international law and is used by many states to interpret tax treaties.

For the part of the thesis intended to make an analysis from the perspective of Swedish law and tax treaties, the Swedish domestic legislation and case-law will be described to determine the legal position in Sweden regarding the norm collision.

BEPS action 6 will be described according to the Action 6 report, and analysed by comments from academic doctrine and practitioners. The comments on action 6 in "Comments received on public discussion draft follow-up work on BEPS Action 6: prevent treaty abuse" are made from different 'interest groups' and can be questioned as legal a source. The interest groups contains of practitioners and academics and relevant concerns according to the author, will be illustrated. The thesis will partly focus on the implementation of the measures suggested in Action 6.

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<sup>8</sup> Dahlberg. M. "Internationell Beskattning", volume 3, Studentlitteratur, Lund, 2012.p. 235.

<sup>9</sup> Douma.S. "Legal research in International and EU tax law" Kluwer, 2014, p. 18.

<sup>10</sup> Douma.S. "Legal research in International and EU tax law" p. 24.

<sup>11</sup> Erasmus-Koen. M. Douma. S. "The legal status of the OECD-Commentaries – in search of the Holy grail of international law", p. 349.



Therefore the report Action 15 on how the measures will be implemented will be described and analysed. For an understanding of issues that might arise in implementing a multilateral instrument, academic doctrine is used.

#### **1.4 Delimitation**

The thesis will focus on the interaction between domestic law and international law and no analyse will be carried out regarding the compatibility with EU law. Although the compatibility with EU law is mentioned due to its importance in the implementation of BEPS. The Commissions Anti-Avoidance package will be referred to but not analysed. The thesis focuses on the OECD Model Convention and will not discuss the United Nations Model Convention. The thesis will not describe how different treaty shopping arrangements or abusive transactions are arranged.

Regarding Swedish anti-avoidance measures it has been stated to exist a substance over form doctrine developed by the court, but which existence has been discussed. Since the substance over form doctrine's scope and status in Swedish law is not entirely clear,<sup>12</sup> it will not be examined further in the thesis.

Delimitations from the BEPS Action 6 report are measures regarding Collective Investment Vehicles. The part of the report discussing the savings clause, exit and departure taxes and domestic tax policy consideration will not be analysed. The LOB, PPT and minimal standard are the focus of the thesis but due to the complexity will not be described in a detailed way. For the Action 15 report the author will only describe briefly how the multilateral instrument is intended to be implemented and not analyse technical issues regarding language or how the compatibility clause will be formed.

#### **1.5 Outline**

Chapter two will describe the terminology so the reader understands how the terms are defined by the author. A description of the area and current law will be carried out, highlighting the issues arising when states use domestic anti-avoidance rules.

Chapter three will describe the Swedish anti-abuse rules and how the relationship between the rules and tax treaties has developed in case law.

Chapter four will describe the suggested provisions in the BEPS Action 6 report followed by an analysis of the suggested measures. Subsequently the implementation of the suggested measures in a multilateral instrument in Action 15 will be described and analysed.

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<sup>12</sup> Benktsson. A. Johansson. A. "Sweden Branch Report" IFA Cachier, 2010, p. 758.

Chapter five will analyse issues regarding the implementation of Action 6 from a Swedish perspective. An analysis if the LOB or PPT is hindered by the constitution in Sweden will be carried out and subsequently a comparison between the PPT and the Swedish GAAR. An analysis if the LOB or PPT is necessary in Sweden is performed.

Chapter six will summarise the thesis and the conclusions the author have made from the research.

## 2 Improper use of treaties and treaty shopping

### 2.1 Terminology

‘Improper use of tax treaties’, ‘treaty abuse’, ‘tax avoidance’ and ‘evasion’ are terms often occurring interchangeably. No uniform definition has been stated in international law of the terms that are closely related.<sup>13</sup> One clear difference can be found since ‘evasion’ refers to a criminal offence or fraud which universally not appears to be the case with tax avoidance or abuse.<sup>14</sup>

Improper use of tax treaties is a broad term that comprises arrangements or transactions being abusive. Therefore the concept do not only cover abuses of the treaty itself but might also cover an improper use of the treaty by using the treaty to abuse domestic legislation of contracting states.<sup>15</sup> In a report on abuse of tax treaties by the United Nations it was stated that despite the ongoing debate of what constitutes treaty abuse there are no definition of the concept since the assessment of abuse differs from state to state. “The existence of a treaty abuse implies an indirect violation of the law, contrary to its goal and objectives. Such a violation can only be determined after taking into account the specific circumstances of a particular case. In general, a treaty abuse is determined by national authorities under their domestic law and according to their legal tradition.”<sup>16</sup>

A general consensus in the discussion regarding the improper use of a tax treaty is that the concept mainly refers to (although not limited to) treaty

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<sup>13</sup> Russo. R. “Fundamentals of International Tax Planning” IBFD, Amsterdam, 2007, p.51; van Wegheel. S. “The Improper Use of Tax Treaties” Kluwer Law International, London, 1998, p. 96; Gerzova. L. Popa. O. “Compatibility of Domestic Anti-avoidance Measures with Tax treaties”, p. 421.

<sup>14</sup> Arnold. B.J. ”Tax treaties and Tax avoidance: the 2003 revisions to the Commentary to the OECD Model” Bullentin – Tax treaty monitor. June 2004, p. 244; Russo. R. “Fundamentals of International Tax Planning” p. 49.

<sup>15</sup> Jiménez. M. “Domestic Anti-abuse Rules and Double Taxation Treaties: a Spanish Perspective – Part 1” Bullentin, November 2002, p. 543

<sup>16</sup> Committee of Experts on International Cooperation in Tax Matters “Abuse of tax treaties and treaty shopping” E/C.18/2005/2, p. 11.

shopping.<sup>17</sup> At the International Fiscal Association (IFA) conference in 2010 the main subject was tax treaties and tax avoidance. The general report states that "if one is guided by the commentary on article 1 OECD MC, one of the most prevalent abuses of the tax treaty itself is treaty shopping."<sup>18</sup> Treaty shopping is referred to as "arrangements through which persons who are not entitled to the benefits of a tax treaty use another person (typically a separate legal entity) who is entitled to such benefits in order to indirectly access such benefits."<sup>19</sup> Another description is "the practice of some investors of the 'borrowing' a tax treaty by forming an entity (usually a corporation) in a country having a favorable tax treaty with the country of source - the country where the investment is to be made..."<sup>20</sup>

The common understanding of the term treaty shopping appears to be that a person who is a resident of a third state attempts to access benefits of a treaty between two contracting states that the person otherwise would not have access to. Treaty shopping originates from the fact that there is a lack of coordination between different tax systems and from the wide network of differentiated treaties with the purpose to avoid double taxation, each with specifically negotiated reciprocal concessions.<sup>21</sup>

An ongoing discussion regards the nature of the term treaty shopping as only including abusive arrangements or if the term also includes legitimate business arrangements.<sup>22</sup> As the definition of treaty shopping is rather general in many cases, the concept could also cover bona fide arrangement, not abusive in nature.<sup>23</sup> However treaty abuse and treaty shopping giving the taxpayer benefits through creation of artificial structures will be the meaning of treaty abuse and treaty shopping in the thesis.

## **2.2 The relationship between domestic law and tax treaties**

When concluding a tax treaty, states accept obligations and acquires rights under international law. Therefore a breach of tax treaty obligations is a

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<sup>17</sup> See for example De Broe. L. Et al. "Tax treaties and Tax avoidance: application of Anti-avoidance Provisions" p. 382; Rosenbloom. D. "Derivative Benefits: Emerging US Treaty Policy" p. 82; van Wegheel. S. "The Improper Use of Tax Treaties" p. 95.

<sup>18</sup> van Weeghel, IFA cahier general report 2010 p. 35.

<sup>19</sup> De Broe. L. Et al. "Tax treaties and Tax avoidance: application of Anti-avoidance Provisions" p. 382.

<sup>20</sup> Rosenbloom.D.H. "Derivative Benefits: Emergins US treaty policy" Intertax, Vol. 24, 1994, p.83.

<sup>21</sup> Barreto. P.A. Takano. C.A. "The prevention of Tax Treaty abuse in the BEPS action 6: A Brazilian perspective" Intertax, Vol. 43, issue 12, 2015, p. 825. 6

<sup>22</sup> See Reuven. S.A. Panayi C.H. "Rethinking Treaty Shopping: Lessons for the European Union" Michigan Law, Public Law and Legal Theory Working Paper Series, Working paper no. 182, January, 2010 p. 3-5.

<sup>23</sup> Jiang.Q. "Treaty shopping and limitation of Benefits articles in the Context of the OECD Base Erosion and profit Shifting Project" Bullentin for International Taxatoin, March 2015, p. 140.

violation of international law.<sup>24</sup> However since many tax treaties and the OECD MC does not contain an explicit provisions addressing the issue of tax avoidance or evasion, states may want to apply their domestic anti-avoidance rules also in treaty situations.<sup>25</sup>

The relationship between domestic law and tax treaties depends on the constitutional order of a state. The monistic or dualistic approach is affecting how the treaties are implemented in domestic law and the degree of acceptance of the use of domestic anti-avoidance provisions.<sup>26</sup> The monistic approach places the tax treaty at a higher hierarchy level, constituting *lex superior*, in relation to domestic tax legislation. According to the dualistic approach the tax treaty is incorporated in domestic law, and the tax treaty can be regarded as *lex specialis* in relation to domestic tax law.<sup>27</sup>

According to international law contracting states must perform their treaty obligations in good faith. The principle of good faith is a fundamental principle in public international law and has been incorporated in VCLT article 26. When entering into a tax treaty contracting states must refrain from using provisions of domestic law since their treaty obligations would be eroded.<sup>28</sup> Of importance for the functioning of the tax treaty is that the contracting states apply the tax treaty consistently, therefore the tax treaty should be interpreted in the light of its object and purpose.<sup>29</sup> Treaty interpretation should therefore be aimed at finding the interpretation that most likely would be accepted in both contracting states.<sup>30</sup>

The interpretation of tax treaties plays an important role in the use of domestic law and the relationship between tax treaties and domestic law. For international agreements the VCLT states the rules regarding the creation and application. Although not all states has assigned to the VCLT many academics is of the opinion that VCLT in many parts codifies existing norms of customary international law.<sup>31</sup>

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<sup>24</sup> Linderfalk. U. "When the International Lawyers Get to Be Heard – The Story of Tax Treaty Interpretation as Told in Sweden" Nordic Tax Journal, 2016; 1:3-16, p.3.

<sup>25</sup> Michel. B. "Anti-Avoidance and Tax Treaty Override: Pacta Sunt Servata?" p. 414.

<sup>26</sup> Gerzova. L. Popa. O. "Compatibility of Domestic Anti-avoidance Measures with Tax treaties", p. 422.

<sup>27</sup> See Sachdeva. S. "Tax Treaties Overrides: A Comparative Study of the Monist and the Dualist Approaches "Intertax, Volume 41, issue 4, Kluwer law international BV, 2013, p.207.

<sup>28</sup> De Broe. L. "International tax planning and prevention of abuse" p. 306.

<sup>29</sup> Article 31.1 Vienna Convention on the Law of Treaties, 1969.

<sup>30</sup> Vogel. K. Rust. A. "Klaus Vogel on Double Taxation Conventions" Fourth Edition, Volume 1, Wolters Kluwer, 2015, p. 41-42.

<sup>31</sup> Vogel. K. Rust. A. "Klaus Vogel on Double Taxation Conventions", p. 24; Arnold B.J "The Interpretation of Tax Treaties: Myth and Reality" Bulletin for International Taxation, 2010 (Volume 64), No. 1. See for a discussion Linderfalk. U. "When the International Lawyers Get to Be Heard – The Story of Tax Treaty Interpretation as Told in Sweden".

If, in case of a norm collision between the tax treaty and domestic law, the conflict is settled in favour for the domestic provision, a treaty override is carried out. If a treaty override can be justified in abusive arrangements will be analysed below. Another interpretation of tax treaty is that no norm conflict arises, and an interpretation in line with a tax treaty's object and purpose could allow treaty benefits not to be granted in an abusive arrangement. This would be the approach of the OECD in the Commentaries described below.

### **2.2.1 The OECD MC Commentary and the guiding principle**

The OECD 2003 Commentary 9.5 on article 1 offers a guiding interpretation principle on abuse of a tax treaty. The commentary states that “benefits of a tax treaty should not be available where a main purpose for entering into a certain arrangement 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 treaty provisions.”<sup>32</sup>

The guiding principle contains two elements, a subjective element, the main purpose for entering into the transaction is to get a more favourable tax treatment, and an objective element, the more favourable treatment is contrary to the object and purpose of the provision. This was added in the 2003 revision of the OECD MC. Before 2003 little was stated about avoidance or evasion except for in the version 1977 of the OECD MC, the main purpose was eliminating double taxation, but the OECD MC also stated that tax treaties “should not, however, help tax avoidance or evasion”.<sup>33</sup>

In the revisions 2003 of the Commentaries the improper use of tax treaties and the relationship between tax treaties and anti-avoidance measures was addressed. The prevention of tax avoidance or abuse was stated more clearly as a purpose of the treaty, although still an ancillary purpose according to academics.<sup>34</sup> The revision to the Commentaries would attempt to clarify the relationship and interaction between tax treaties and domestic anti-avoidance rules.<sup>35</sup>

According to the Commentaries there are two fundamental issues regarding anti- avoidance and tax treaties. The first issue is the conflict between domestic anti-avoidance provisions and tax treaties. The second issue is

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<sup>32</sup> OECD Commentary (2014) art. 1, para.9.5.

<sup>33</sup> OECD Commentary (1977) art. 1, para.7.

<sup>34</sup> Arnold. B.J. "Tax treaties and Tax avoidance: the 2003 revisions to the Commentary to the OECD Model" p. 248; De Broe. L. Et al. "Tax treaties and Tax avoidance: application of Anti-avoidance Provisions" p. 382.

<sup>35</sup> Arnold. B.J. "Tax treaties and Tax avoidance: the 2003 revisions to the Commentary to the OECD Model", p. 244.

whether treaty benefits have to be granted despite the fact that a transaction constitutes abuse.<sup>36</sup> The Commentaries makes a distinction between states considering the abuse of the tax treaty as also constituting an abuse of the domestic law, since domestic law impose taxes.<sup>37</sup> The other type of state considers abuse of treaty as being abuse of the treaty itself. The former type of state will according to the Commentaries solve the conflict by a correct interpretation of the purpose of the tax treaty. The latter state will be able to use domestic anti-avoidance rules to the extent anti-avoidance rules are part of the basic domestic rules determining the facts that give rise to a tax liability. Rules determining tax liability are not addressed in tax treaties and therefore not affected by them.<sup>38</sup> Thus, as a general rule, there will be no conflict between anti-avoidance rules and the provisions of tax treaties.<sup>39</sup> This statement is followed by the general statement that it should not be ‘lightly assumed’ that a transaction is abusive and that as long as there is no clear evidence that tax treaties are being abused, the obligations enshrined in the tax treaties should be observed.<sup>40</sup>

The statement in the Commentaries that there is no conflict between tax treaties and domestic law has been questioned and criticised in academic doctrine. According to van Weeghel and Arnold this proposition can be questioned since it relies on the fact that domestic anti-avoidance rules establishes the circumstances under which the tax treaty applies. De Pietro in a detailed analysis of the statement concludes that the statement is not justified.<sup>41</sup> The reason is first of all that the classification of abuse cannot concern merely the determination of the facts that creates tax liability. The functioning between domestic law and tax treaties is that taxes are imposed under the domestic law of the states and therefore the tax liability is established by the domestic law. The tax treaties do not therefore impose taxes but through the distributive rules restrict the tax imposed by the state. Consequently the tax treaties also affect the tax liability for the taxpayers.<sup>42</sup> According to the UN this approach can be questioned from an international law point of view and the principle of *pacta sunt servanda*, if the use of domestic law leads to increasing the tax liability for the taxpayer beyond what the tax treaty allows.<sup>43</sup>

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<sup>36</sup> OECD Commentary (2014) art.1, para. 9.1.

<sup>37</sup> OECD Commentary (2014) art.1, para. 9.2

<sup>38</sup> OECD Commentary (2014) art.1, para. 22.1.

<sup>39</sup> OECD Commentary (2014) art.1, para. 22.1.

<sup>40</sup> OECD Commentary (2014) art.1, para.9.5 and 22.2.

<sup>41</sup> De Pietro. C. "Tax Treaty Override" Eurotax Series on European Taxation, Vol. 40, Netherlands, 2014, p. 109-113.

<sup>42</sup> De Pietro. C. "Tax Treaty Override" p. 109-113.

<sup>43</sup> Committee of Experts on International Cooperation in Tax Matters "Abuse of tax treaties and treaty shopping" E/C.18/2005/2, p. 9.

The relationship between domestic anti-abuse provisions and tax treaties are not a clear-cut issue and despite the revision in the 2003 OECD MC Commentary the question still is; is there a possibility to derogate from the tax treaty to prevent tax evasion or avoidance?

### 2.2.2 Tax treaty override

If a contracting state is applying domestic law and taxing an income despite a provision in a tax treaty, the state derogates from the obligations of a binding treaty which constitutes a tax treaty override prohibited by international law.

Two approaches regarding treaty override can be interpreted from the VCLT. According to article 26, *pacta sunt servanda* the states have to interpret the treaty in good faith and refrain from using domestic provisions in a situation where the tax treaty and domestic law collide. The other approach can be found according to article 31.1 VCLT stating that “a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”<sup>44</sup> By stating that an object and purpose of the tax treaty is preventing tax avoidance or evasion the use of a domestic provision could be justified. An interpretation according to article 31 VCLT requires that the object and purpose of the treaty can be stated as being prevention of abuse from the context of the treaty.<sup>45</sup> This interpretation can therefore be questioned since tax evasion or avoidance is not clearly stated as the purpose and object of the treaty. The interpretation can be supported from the 2003 revision of the Commentaries but on the other hand the Commentaries might not be a valid source of interpretation of the tax treaty’s purpose. The question of the legal value of the Commentaries has no general answer.<sup>46</sup> The OECD member states are not legally bound by the Commentaries, but the general consensus appears to be that the Commentaries are legally relevant for the interpretation of a tax treaty.<sup>47</sup>

According to Vogel and Rust the OECD MC and its Commentaries are an important source of interpretation for finding the common intention of the contracting states. However only the version of the Commentaries that was applicable at the time the parties entered into the tax treaty can be concluded

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<sup>44</sup> Article 31.1, Vienna Convention on the Law of Treaties (1969).

<sup>45</sup> De Broe. L. ”International tax planning and prevention of abuse” p. 316.

<sup>46</sup> For discussion see for example Erasmus-Koen. M. Douma. S. “Legal Status of the OECD Commentaries - In Search of the Holy Grail of International Tax Law”; Linderfalk. U. Hilling. M. “The Use of OECD Commentaries as Interpretative Aids: The Static/Ambulatory-Approaches Debate Considered from the Perspective of International Law” Nordic Tax Journal, Volume 1, 2015.

<sup>47</sup> Vogel. K. “The Influence of the OECD Commentaries on Treaty Interpretation” Bulletin - Tax Treaty Monitor, 2006, p. 616; Linderfalk. U. Hilling. M. “The Use of OECD Commentaries as Interpretative Aids: The Static/Ambulatory-Approaches Debate Considered from the Perspective of International Law” p. 42.

as the common intention of the parties.<sup>48</sup> Dahlberg states the Commentaries alone cannot be decisive when interpreting a tax treaty. The reason is that the OECD MC does not have constitutional legitimacy and generally not adequate legitimacy in international law.<sup>49</sup>

If changes to the Commentaries should be taken into account when interpreting a tax treaty concluded prior to the changes is a topic debated by many academics.<sup>50</sup> An ambulatory or static approach can be taken. With the static approach an interpreter will use the version of the Commentaries available at the time the treaty was concluded. With an ambulatory approach the interpretation is of the version of the Commentaries adopted after the conclusion of the treaty.<sup>51</sup> Since states use different approaches, an interpretation of the OECD MC Commentaries can lead to different results in the contracting states.

### 2.3 Summary

The problem of using domestic anti-avoidance rules to prevent abusive transactions is that the use of domestic law may constitute a tax treaty override. To tax an income when the state has no taxing rights according to the tax treaty is prohibited by international law. An interpretation of the tax treaty's object and purpose as being to prevent abusive transactions could possibly justify the use of domestic anti-avoidance rules. Such an interpretation requires that the prevention of abuse can be stated from the context of the tax treaty according to article 31 VCLT. As for now the Commentaries to the OECD MC states that domestic anti-avoidance rules can be applied in cases of clear evidence of abuse. The issue is that the legal value of the Commentaries as a source of interpretation is questionable since the Commentaries are recommendations, not binding on the contracting states. Furthermore tax treaties concluded before the 2003 revision of the Commentaries might not be used for interpretation for tax treaties concluded before 2003 if a static interpretation method is used.

## 3 The Swedish perspective

### 3.1 Basic principles of Swedish international tax law

Sweden is a dualistic state and the tax treaties are incorporated in domestic Swedish law.<sup>52</sup> The incorporation requires two decisions by the Parliament

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<sup>48</sup> Vogel. K. Rust. A. "Klaus Vogel on Double Taxation Conventions" p. 45-48.

<sup>49</sup> Dahlberg. M. "Internationell beskattning" p. 241.

<sup>50</sup> See for example Vogel. K. "The Influence of the OECD Commentaries on Treaty Interpretation".

<sup>51</sup> Lindefalk. U. Hilling. M. "The Use of OECD Commentaries as Interpretative Aids: The Static/Ambulatory-Approaches Debate Considered from the Perspective of International Law" p. 34.

<sup>52</sup> Dahlberg. M. "Internationell Beskattning" p. 244.



that first it approves and ratifies the tax treaty; this makes the tax treaty binding vis-à-vis the contracting state. Secondly the tax treaty is incorporated into Swedish domestic law.<sup>53</sup> The tax treaty creates therefore obligations both under international law as an international agreement and under domestic law as the tax treaty is incorporated into domestic tax law. A tax treaty can never extend or create tax liability that is not stated by Swedish statutory law, therefore tax treaties can never generate, only limit, tax liability. For the interpretation of tax treaties and terms used therein the principles for interpretation of international agreements as stated in the principle in VCLT are followed, and the Commentaries to the OECD MC is taken into account for determining the intention of the contracting states.<sup>54</sup>

### 3.2 Anti-abuse measures in Sweden

There are two concepts in Sweden for the prevention of abuse. Specific anti-avoidance rules (SAAR) consisting of Controlled Foreign Company (CFC) - rules, exit taxation, limitation of interest deductions and transfer pricing rules. There is also an Anti-avoidance act containing a GAAR aimed at preventing avoidance or abuse of domestic law.<sup>55</sup>

The Anti-Avoidance Act and the GAAR enables the Administrative Court to, for tax purposes, disregard a transaction that fulfils the criteria for an abusive transaction. The Tax Agency can refer the question of applicability of the Anti-avoidance Act to the Administrative Court but the Swedish Tax Agency can never apply the Anti-Avoidance Act.<sup>56</sup> According to the GAAR a transaction may be deemed to be an act of tax avoidance and result in the transaction being disregarded for tax purposes if all the following requirements are met: “the transaction, alone or in conjunction with another transaction, results in a significant tax benefit for the tax payer; the taxpayer is, directly or indirectly, a party to a transaction; such a tax benefit is assumed to have been the predominant reason for the transaction; and taxation on the basis of the transaction would be in violation of the purpose of the law.”<sup>57</sup>

The effect of the GAAR being applied is that the transaction is disregarded either with the result that the taxpayer is taxed as the transaction was never carried out, was carried out in another way, or to a reasonable amount.<sup>58</sup> The

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<sup>53</sup> Wiman. B. “Sweden: Trailing Taxes and CFC Rules vs Tax Treaties” in “Tax Treaty Case Law Around the Globe – 2011” Eurotax series on European taxation, vol. 34, 2011, Wolters Kluwer, p. 299.

<sup>54</sup> See RÅ 1996 ref. 84; Benktsson. A. Johansson. A. “Sweden Branch Report” IFA Cachier, 2010, p. 759; Dahlberg. M. “Internationell Beskatting” p.241.

<sup>55</sup> Benktsson. A. Johansson. A. “Sweden Branch Report” IFA Cachier, 2010, p. 751.

<sup>56</sup> 4§ Lag (1995:575) mot skatteflykt.

<sup>57</sup> 2§ Lag (1995:575) mot skatteflykt, translation IBFD “Sweden - Corporate Taxation - Country Surveys - 7. Anti-Avoidance”

<sup>58</sup> 3 § Lag (1995:575) mot skatteflykt, Anti-Avoidance Act.

GAAR has been questioned by academics as not being compatible with the principle of legality stated in the Swedish constitution.<sup>59</sup>

### 3.3 Relationship tax treaties and domestic anti-avoidance rules

Due to the dualistic approach the tax treaties belongs to two legal sources, international law and domestic law. Generally when tax treaties has been incorporated in Swedish domestic law, the tax treaty takes precedence over domestic law due to the obligations from the international agreement, except in specific circumstances developed by case law.<sup>60</sup>

In 2008, a criticised ruling RÅ 2008 ref. 24, was decided by the Supreme Administrative Court regarding applicability of CFC-legislation. The Swedish Supreme Administrative Court applied the domestic CFC-legislation to tax income that was not taxable in Sweden according to the tax treaty. The relationship between the tax treaty and the CFC-legislation was decided by the derogation principles as developed by general law. Since the tax treaties are incorporated into Swedish domestic law, the CFC-legislation that was incorporated after the tax treaty and could be seen as *lex posterior* or *lex specialis* according to the Court. The Supreme Administrative Court stated that domestic anti-avoidance rules incorporated after the tax treaty, may be applied with no consideration taken to the tax treaty. This judgement was criticised as it amounted to accepting treaty override.<sup>61</sup>

In a subsequent judgement by the Supreme Administrative Court, RÅ 2010 ref. 112, the Supreme Administrative Court partly changed the legal position from RÅ 2008 ref 24. The case regarded the relationship between tax treaties and an anti-avoidance rule giving Sweden taxing rights for a former resident's capital gains if the taxpayer had lived in Sweden in the last 10 years.<sup>62</sup> According to the tax treaty Sweden did not have any taxing rights. The Supreme Administrative Court stated that a well-established principle is that the tax treaty has priority over the domestic anti-abuse rules and can limit the application of domestic rules. Therefore the derogation principles *lex specialis* and *lex posterior* cannot normally be used, consequently not applying the statement from the Supreme Administrative Court in the 2008 judgment. A statement derogating from the traditional view in the judgement was that if the legislator had in a clear statement expressed the intention that a certain income is to be taxed in Sweden, the legislation should apply irrespective of the applicable tax treaty. On the other hand if the legislator's intentions are not clearly expressed regarding

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<sup>59</sup> Hultqvist. A. "Skatteundvikande förfaranden och skatteflykt" p. 308. (Note that there is a discussion regarding if the principles of legality is stated in the constitution in Sweden.)

<sup>60</sup> Skatteverkets handledning för beskattning av inkomst vid 2013 års taxering, vol. 1, p. 86.

<sup>61</sup> See for example Wiman. B. "Sweden: Trailing Taxes and CFC Rules vs Tax Treaties" in "Tax Treaty Case Law Around the Globe – 2011" p. 301.

<sup>62</sup> 3:19 Inkomstskattelag (1999:1229), Income Tax act.

the circumstances in a specific case the domestic law cannot be given precedence over the tax treaty.<sup>63</sup>

The above stated cases regarded applicability of domestic SAARs on arrangement where the domestic anti-avoidance provisions would have been hindered by the tax treaty. The application of the Swedish GAAR despite a tax treaty was the subject of the judgement in HFD 2012 ref. 20. The case regarded an arrangement in Peru, using the tax treaty to benefit from a more preferential tax treatment.<sup>64</sup> The Swedish Tax Agency was of the opinion that the Swedish GAAR was applicable on the arrangements. The Supreme Administrative Court stated that in the Swedish Anti-Avoidance Act no exception had been specified for arrangements under a tax treaty, and that in the tax treaty nothing was stated to exclude the use of the Anti-Avoidance Act. The Supreme Administrative Court stated that since there was no statement in the tax treaty excluding the use of domestic anti-avoidance rules, the common intent of the contracting state was that the domestic anti-avoidance rule could be applied.<sup>65</sup> Consequently according to the Swedish Administrative Court no explicit statement in the tax treaty was needed to apply the Swedish Anti-Avoidance Act.

The judgement is questionable from an international law point of view and the principle of interpretation in good faith. According to many academics the interpretation need explicit support in the treaty. Since an interpretation according to VCLT shall be carried out from the context and in the light of the object and purpose of the treaty, the lack of a statement in the tax treaty to be interpreted as the common intention of the contracting states is questionable.

Lang is of the opinion that treaty benefits cannot be denied due to domestic anti-avoidance legislation. Lang states that because tax treaty law and domestic law are two separate legal systems for the purpose of interpretation, the function of the tax treaty to eliminate or reduce domestic tax is lost if the tax treaty is interpreted by reference to domestic anti-avoidance rules.<sup>66</sup> Dahlberg is of the opinion that a contracting state restrictively should apply domestic anti-avoidance rules in situations regulated by a tax treaty if the intention to use domestic anti-avoidance rules is not stated in the tax treaty.<sup>67</sup>

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<sup>63</sup> Wiman. B. "Tax Treaty Case Law Around the Globe – 2011" p. 302-303.

<sup>64</sup> Hilling. M. "HFD:s Peru-domar" Skattenytt, 2012, p. 583.

<sup>65</sup> HFD 2012 ref.20, Case nr: 1336-11, para. 4.

<sup>66</sup> Lang. M. "Introduction to the Law of Double Taxation Conventions" Second Revised Edition, online book, chapter 5.2.

<sup>67</sup> Dahlberg. M. "Internationell Beskattning" p. 256.

### 3.4 Summary

According to the current law in Sweden a tax treaty still, with reservations, takes precedence over internal law. In special circumstances or where the legislator clearly has expressed that the intention is that a domestic rule should be used in conflict with the tax treaty, the domestic rule can take precedence.<sup>68</sup> Further the Supreme Administrative Court has stated that as long as there is no statement in the treaty that the intention of the contracting states is that domestic anti-avoidance rules can be used, the domestic rule can prevail over the tax treaty.<sup>69</sup> This statement is supported by the OECD revised commentary 2003 but the legal position is still problematic from an international law perspective. It amounts to treaty override and could create legal uncertainty for taxpayers since the contracting states can interpret the tax treaties in different ways. Further it can be questioned if the OECD Commentary is a valid legal source of interpretation for the purpose of the treaty.

BEPS Action 6 indicates that the 2003 revision to the Commentaries was not sufficient to prevent tax treaty abuse or improper use of tax treaties. An inclusion of anti-avoidance measures in the tax treaties has therefore been suggested in BEPS action 6 which will be described below.

## 4 BEPS action 6 – Preventing the Granting of Treaty Benefits in Inappropriate circumstances

### 4.1 The aim of action 6

OECD and G20 have identified treaty abuse, and treaty shopping in particular as one of the most important issues in the BEPS project.<sup>70</sup> According to the report the state's tax sovereignty is undermined as a consequence of taxpayers claiming treaty benefits in situations where these benefits were not intended to be granted. As a result states are deprived of their tax revenues.<sup>71</sup> The report recognises that the OECD MC Commentaries of article 1 of the OECD MC contains a number of provisions that could be used for the attempt to prevent treaty shopping and other cases of abuse of the treaty. Strict treaty anti-abuse provisions in combination with the exercise of taxing rights under domestic laws will help to restore source taxation in various cases. The main view of the report is to modify existing domestic and international tax rules “in order to more closely align the allocation of income with the economic activity that

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<sup>68</sup> RÅ 2010 ref.112.

<sup>69</sup> HFD 2012 ref. 20.

<sup>70</sup> OECD, Action 6 – 2015 Final Report, p. 9.

<sup>71</sup> OECD, Action 6 – 2015 Final Report, p. 9.

generates the income”<sup>72</sup> Three different areas have been identified in the work of Action 6 and suggested measures are:

“A. Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the grating of treaty benefits in inappropriate circumstances.

B. Clarify that tax treaties are not intended to be used to generate double non-taxation.

C. Identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country.”<sup>73</sup>

Area A and B will be described below and area C will not be described further in the thesis. Area A includes a separation of two types of cases: “1. Cases where a person tries to circumvent limitations provided by the treaty itself; 2. Cases where a person tries to circumvent the provisions of domestic law using treaty benefits.”<sup>74</sup> The type 1 cases mainly consist of treaty abuse in form of treaty shopping, defined above, and likely also rule shopping arrangements meaning that a person, entitled to benefits of a treaty, undertakes a transaction or arrangement to benefit from a more favourable rule within the treaty.<sup>75</sup> Type 2 cases on the other hand, regards cases where the domestic law is being circumvented by a taxpayer, using the tax treaty to prevent the application of domestic anti-abuse rules. The element of abuse in these cases is the avoidance of domestic law, and does not amount to treaty abuse.<sup>76</sup> As stated above, both cases are on the other hand referred to by the author as improper use of tax treaties.

Action 6 states that a minimal standard to address treaty abuse should be implemented. The minimal standard should consist of a clear statement in the tax treaty stating that the contracting states wish to prevent tax avoidance and to avoid generating opportunities for treaty shopping when entering into a treaty. Second, a SAAR would be included in the OECD MC, based on the Limitation on Benefits contained in existing treaties between United States and a few other countries. Thirdly, to target other form of treaty abuse not covered by the LOB a GAAR would be included in the OECD MC. The GAAR would deny treaty benefits if the principal purpose of the transaction or arrangement would be to obtain treaty benefits, the principal purpose test, PPT. The PPT will incorporate the guiding principle in current commentary 9.5 to article 1 of the OECD MC.<sup>77</sup>

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<sup>72</sup> OECD, Action 6 – 2015 Final Report, p. 13.

<sup>73</sup> OECD, Action 6 – 2015 Final Report, p. 13.

<sup>74</sup> OECD, Action 6 – 2015 Final Report, p. 17.

<sup>75</sup> De Broe, L. Luts. J. “*BEPS action 6: Tax Treaty Abuse*” Intertax, volume. 43, issue 2, 2015, p. 125.

<sup>76</sup> De Broe, L. Luts. J. “*BEPS action 6: Tax Treaty Abuse*” p. 126.

<sup>77</sup> OECD, Action 6 – 2015 Final Report, p. 19.

The report recognises that it is important to note that the suggested measures need to be implemented in accordance with specificities of individual states and the circumstances of the negotiation between the states entering into the convention. This can for example be due to a state's constitutional restrictions or that a state has concerns regarding EU law preventing them from implementing the exact wording of provisions suggested in the report. Furthermore domestic anti-abuse provisions can already be preventing abuse of treaties described in the report and to the extent these provisions is in conformity with the principles in the report, the LOB or PPT might not be necessary.<sup>78</sup> Interpretative tools developed by the court in a state might already address treaty abuse. In these countries PPT might not be needed or a more restricted form might be preferable. Further the administrative capacity of some states might preclude them from adopting certain detailed treaty rules and might therefore need to implement solely the PPT.<sup>79</sup>

Accordingly the suggested provisions in the report can be implemented with a certain degree of flexibility, the LOB and the PPT are therefore not mandatory. However the report states that the common goal is to incorporate in tax treaties sufficient measures to prevent treaty abuse, and treaty shopping in particular. For this reason the minimum standard should be implemented.<sup>80</sup>

## 4.2 Limitation on Benefits

The LOB is not a new concept for OECD since a LOB provision is included in the commentaries to article 1, paragraph 20. The LOB suggested is now to be included in the OECD MC. The specific anti-avoidance rule will be based on already existing provisions in treaties primarily concluded by the United States but also Japan and India. The LOB address the problem that arise because the granting of treaty benefits has been based on the residency of the party claiming treaty benefits, making tax treaties vulnerable to abuse.<sup>81</sup>

The report suggests a simplified or a detailed version of the LOB clause. The clause will need to be reviewed since the United States released a new version of the LOB in their model convention. When the LOB is finalised in United States the LOB suggested in BEPS will be reviewed.<sup>82</sup> In short the LOB preserves the right to treaty benefits only to residents that either carries out real business activities, have an adequate nexus to their residence state or have genuine business motives.<sup>83</sup> Treaty benefits constitutes according to

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<sup>78</sup> OECD, Action 6 – 2015 Final Report, p. 14.

<sup>79</sup> OECD, Action 6 – 2015 Final Report, p. 14.

<sup>80</sup> OECD, Action 6 – 2015 Final Report, p. 14.

<sup>81</sup> Bates. J. et al "Limitation on Benefits Articles in Income Tax Treaties: The current State of Play" *Intertax*, volume 41, issue 6&7, Kluwer International BV, 2013, p. 395

<sup>82</sup> OECD, Action 6 – 2015 Final Report, p. 20.

<sup>83</sup> De Broe. L. Luts "BEPS Action 6: Tax Treaty Abuse" p. 128.

the report the distributive and relief rules limiting the taxing rights of the contracting states, article 6-23 OECD MC. The non-discrimination article 24 OECD MC it also considered a treaty benefit subject to the LOB clause.<sup>84</sup>

The suggested LOB article contains six paragraphs describing a category of residents that will be estimated as qualified persons due to the attributions of the person. Paragraph 1 of the LOB states that a resident of a contracting state shall only be entitled to the benefits accorded by this convention if the resident is a qualified person, except otherwise provided in the following paragraphs.<sup>85</sup> Paragraph 1 of the LOB would restrict the general scope of the tax treaty as stated in article 1 in the MC. Article 1 in the MC states that the tax treaty applies to persons who are residents of a contracting state. According to paragraph 1 of the LOB clause a resident of a contracting state should only be entitled to treaty benefits if the person is a “qualified person” defined under paragraph 2 of the LOB clause. Who constitutes a “qualified person” is determined by the subparagraphs of the article, “(a) individuals, (b) contracting States and subdivisions thereof, (c) entities that comply with the stock exchange test, (d) charitable organizations and pension funds expressly indicated (e) entities meeting the ownership and base erosion test and (f) collective investment vehicles expressly indicated.”<sup>86</sup> If one of these tests is fulfilled, a person is considered to have sufficient nexus with its resident state.<sup>87</sup>

Paragraphs 3, 4 and 5 describe circumstances where a person is entitled to treaty benefits even though not being a qualified person. Under paragraph 3 a person not being a qualified person can still be entitled to benefits if the person is engaged in active conduct of business in its state of residence and the item of income is derived in connection with the business.<sup>88</sup>

Paragraph 4 is a “derivative benefits” rule stating that entities owned by a person resident in a third state, not being a qualified person under paragraph 2, would still be entitled to benefits provided that the person would have been entitled to benefits if the person would have invested directly.<sup>89</sup>

Paragraph 5 contains a provision allowing the competent authority of a contracting state to grant the benefits of the convention not being granted by previous provisions in the article.<sup>90</sup> A person must establish that there where non-tax business reasons for the conduct of its formation, acquisition or

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<sup>84</sup> OECD, Action 6 – 2015 Final Report, p. 24; De Broe. L. Luts “BEPS Action 6: Tax Treaty Abuse” p. 128-129;

<sup>85</sup> OECD, Action 6 – 2015 Final Report, p. 23.

<sup>86</sup> OECD, Action 6 – 2015 Final Report, p. 23.

<sup>87</sup> De Broe. L. Luts “BEPS Action 6: Tax Treaty Abuse” p. 129.

<sup>88</sup> OECD, Action 6 – 2015 Final Report, p. 21, 23, 37.

<sup>89</sup> OECD, Action 6 – 2015 Final Report, p. 23.

<sup>90</sup> OECD, Action 6 – 2015 Final Report, p. 23.

maintenance in the other contracting state for the article to be applicable.<sup>91</sup> Finally paragraph 6 contains a number of definitions that apply for the purpose of the article.

The LOB clause will only be able to restrict the application of a treaty and not to extend the use of the treaty. Therefore the LOB will be applicable under the prerequisite that the other requirements of the treaty are fulfilled, for example being a resident under article 4 of the MC or being the beneficial owner of an income.<sup>92</sup>

### 4.3 Principal Purpose test

The suggested article “Entitlement to benefits”, paragraph 7 states: “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.”<sup>93</sup> This is referred to as the principal purpose test, PPT.

The test includes a subjective and an objective test for treaty benefits to be granted. The subjective test is that the principal purposes of the arrangement resulted directly or indirectly in the benefit, the objective test is that the access to treaty benefits in the circumstances would be in accordance with the object and purpose of the convention.<sup>94</sup>

The suggested commentaries states that the paragraph mirrors the guidance in the Commentaries to article 1 in the OECD MC paragraphs 9.5, 22, 22.1 and 22.2 described above. The principles underlying these paragraphs would be incorporated in the MC through paragraph 7 so that states can address the improper use of tax treaties if a state’s domestic law does not allow an interpretation in accordance with the paragraphs 9.5, 22.1 and 22.2 in the OECD MC Commentary to article 1.<sup>95</sup>

According to the objective test the taxpayer who is being denied the benefits of a treaty to establish that obtaining the benefits would not be against the purpose of the relevant provision of the tax treaty.<sup>96</sup> The benefits of the

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<sup>91</sup> OECD, Action 6 – 2015 Final Report, p. 44.

<sup>92</sup> OECD, Action 6 – 2015 Final Report, p. 24.

<sup>93</sup> OECD, Action 6 – 2015 Final Report, p. 55.

<sup>94</sup> Kok. R. “ The Principal Purpose Test in Tax Treaties under BEPS action 6” Intertax, Volume 44, issue 5, Kluwer Law International BV, 2016, p. 407.

<sup>95</sup> OECD, Action 6 – 2015 Final Report, p. 55; De Broe. L. Luts “BEPS Action 6: Tax Treaty Abuse” p. 131.

<sup>96</sup> OECD, Action 6 – 2015 Final Report, p. 55.



article includes the same benefits as under the LOB, the distribution and relief rules, article 6-23 and article 24.<sup>97</sup>

The suggested commentaries states that the PPT supplements the LOB provision, and does not restrict the scope or application of the LOB provision in any way. On the other hand, the PPT can deny treaty benefits even though it is granted under the LOB. Paragraph 7 should be read in context of the LOB provisions with the rest of the convention, including its preamble. This is of great importance for the determination of the purpose and object of the relevant provisions as stated in the paragraph.<sup>98</sup> To determine whether or not one of the principal purposes of the person conducting a transaction or arrangement is to obtain a benefit under the convention, an objective analysis must be carried out of the aim and object of all persons involved in the transaction or arrangement. This can only be determined by considering all circumstances and on a case by case basis. The commentaries states that it is not required to find conclusive proof of the intention of the person conducting the arrangement or transaction, but that it must be reasonable to determine, after an objective analysis of relevant facts and circumstances that one of the principal purposes was to obtain the benefits of the tax convention. It should not be lightly assumed however that this is the case.<sup>99</sup>

#### **4.4 Abuse of domestic law using treaty benefits**

The other situation targeted in Action 6 is the improper use of domestic law facilitated by tax treaties. The main objective of this part of the Action plan is to make sure that tax treaties do not preclude the use of specific domestic law provisions that would hinder situations of abuse of domestic provisions.<sup>100</sup> Examples of situations where the granting of treaty benefits would be inappropriate and result in avoidance of tax is where a provision of a tax treaty hinders the use of domestic GAARs or SAARs.<sup>101</sup> The Commentary to the OECD MC addresses some of this issues but the report suggests revising the commentary to better articulate the relationship between tax treaties and domestic anti-avoidance or abuse rules.<sup>102</sup>

The suggested commentaries separates, as the existing OECD MC Commentaries, between the states which consider abuse of the tax treaty as abuse of domestic law since taxes ultimately are imposed through domestic law. Or the states consider abuse as abuse of the tax treaty itself. For the same reasons as described above, the suggested commentaries states that as

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<sup>97</sup> OECD, Action 6 – 2015 Final Report, p. 56.

<sup>98</sup> OECD, Action 6 – 2015 Final Report, p. 56.

<sup>99</sup> OECD, Action 6 – 2015 Final Report, p. 58.

<sup>100</sup> OECD, Action 6 – 2015 Final Report, p. 78.

<sup>101</sup> OECD, Action 6 – 2015 Final Report, p. 78-79.

<sup>102</sup> OECD, Action 6 – 2015 Final Report, p. 80.

a general rule there will be no conflict between tax treaties and domestic law.<sup>103</sup> While the conclusion is that there will be no conflict between tax treaties and domestic anti-abuse provisions, the suggested commentaries would also state that “...member countries should carefully observe the specific obligations enshrined in tax treaties to relieve double taxation as long as there is no clear evidence that the treaties are being abused.”<sup>104</sup>

#### 4.5 The minimum standard

The only measure that should be mandatory according to BEPS Action 6 is the inclusion of a minimal standard clarifying that “tax treaties are not intended to be used to generate double non-taxation”<sup>105</sup>. To provide this clarification the suggestion is to include in the title to the OECD MC, that the prevention of tax avoidance and tax evasion is a purpose of tax treaties. It is further stated in the report that the OECD MC should include in the preamble a statement expressing that contracting states entering into a tax treaty has the intention to eliminate double taxation without creating opportunities for tax avoidance or evasion.<sup>106</sup>

The inclusion of this statement in the preamble will according to the report be relevant for the interpretation and application of the treaty. The report refers to the VCLT article 31(1) “a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given the terms of the treaty *in their context* and in the light of *its object and purpose*”<sup>107</sup> and observe that article 31(2) VCLT states that for the purpose of this rule, the context of a treaty includes the preamble.<sup>108</sup> Therefore the inclusion in the title and in the preamble will play an important role in the interpretation of tax treaties.<sup>109</sup>

Action 6 suggests further changes to the introduction to the OECD MC that will make it evident that the tax treaty has several purposes, including prevention of tax avoidance or evasion.<sup>110</sup>

##### 4.5.1 Comments on Action 6

The main concerns regarding Action 6 from academic doctrine and interest groups is the complexity of the LOB-clause and the subjectivity and vagueness of the PPT-rule.<sup>111</sup>

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<sup>103</sup> OECD, Action 6 – 2015 Final Report, p. 83.

<sup>104</sup> OECD, Action 6 – 2015 Final Report, p. 85, suggested commentary para. 26.7.

<sup>105</sup> OECD, Action 6 – 2015 Final Report, p. 91.

<sup>106</sup> OECD, Action 6 – 2015 Final Report, p. 91

<sup>107</sup> OECD, Action 6 – 2015 Final Report, p. 92, para 73, article 31(1) VCLT, emphasis from the report.

<sup>108</sup> OECD, Action 6 – 2015 Final Report, p. 92.

<sup>109</sup> OECD, Action 6 – 2015 Final Report, p. 93.

<sup>110</sup> OECD, Action 6 – 2015 Final Report, p. 80-86.

<sup>111</sup> Comments received in revised public discussion draft Follow-up work on BEPs action 6: Prevent treaty abuse” June 2015, p. 95; p. 117; Bång. N. Sträng. T.” Kommentarer till

Following the Revised Public Discussion Draft released 2014, a report containing response and comments to the discussion draft was released "Follow-up work on BEPS Action 6: Preventing treaty abuse". The report contains comments from various interest groups. The BEPS monitoring group expresses the concern that a requirement for Action 6 to work is cooperation from all states, which can be problematic.<sup>112</sup> The flexibility suggested in action 6, allowing different combinations of the different provisions makes the implementation of the action plan in the multilateral instrument challenging.<sup>113</sup>

A recurrent concern from interest groups are that tax treaties need to provide certainty to taxpayers and that the taxpayer will not be able to know the result of transactions.<sup>114</sup> The uncertainty will have a negative impact on cross-border investments.<sup>115</sup> Many interest groups have also expressed a concern due to the indications that governments have not been able to reach an agreement on several issues, and disagreements between governments could lead to different implementations of the recommendations across different jurisdictions. This could lead to uncertainty and a very complex international tax treaty system.<sup>116</sup>

An issue not addressed in the Action 6 report is that countries have different interpretation of terms. In the report abuse and avoidance is used somewhat interchangeably and countries may still interpret terms as treaty abuse or avoidance differently. A risk could be that avoidance is interpreted broadly to also cover arrangements which do have economic substance but result in a lower tax burden than subjectively and unilaterally tax authorities prefer.<sup>117</sup> The report should target only wholly artificial arrangement or artificial arrangements that are not the intention of both contracting states in a bilateral treaty. A risk regarding this issue is that different countries define treaty abuse and treaty shopping differently according to domestic anti-abuse laws. The country unilaterally denies access to treaty benefits through allegations of abuse and the unilateral interpretation of what constitutes

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BEPS action 6" Svensk Skattetidning 2014:10 p. 774; Jiang. Q. "Treaty shopping and Limitation on Benefits Articles in the Context of the OECD Base Erosion and Profit Shifting Project" p. 148. De Broe. L. Luts. J. "BEPS action 6: Tax Treaty Abuse" p. 146.

<sup>112</sup> Comments received in revised public discussion draft Follow-up work on BEPs action 6: Prevent treaty abuse" June 2015 p. 44; p. 84.

<sup>113</sup> Comments received in revised public discussion draft Follow-up work on BEPs action 6: Prevent treaty abuse" June 2015, p. 55; p. 342; Malherbe. J. "BEPS, The Issues of Dispute Resolution and Introduction Of a Multilateral Treaty" p. 94.

<sup>114</sup> "Comments received in revised public discussion draft Follow-up work on BEPs action 6: Prevent treaty abuse" June 2015, p. 8; p.41-42; p. 357.

<sup>115</sup> "Comments received in revised public discussion draft Follow-up work on BEPs action 6: Prevent treaty abuse" June 2015, p. 24.

<sup>116</sup> "Comments received in revised public discussion draft Follow-up work on BEPs action 6: Prevent treaty abuse" June 2015, p. 8; p. 84; p. 342.

<sup>117</sup> Comments received in revised public discussion draft Follow-up work on BEPs action 6: Prevent treaty abuse" June2015, p. 102.

abuse leading to a unilateral treaty override. This would significantly add a risk to foreign direct investment and might negatively affect cross-border investments.<sup>118</sup>

The LOB has a rule based character and can for that reason bring legal certainty, on the other hand the LOB's complexity can make it hard for taxpayers be able to understand the rule.

The main concern regarding the PPT is that it is broad and vague. The rule allows broad discretion to tax authorities and could lead to misinterpretation and uncertainty. Further critic has been raised from the interest groups and academics regarding the formulation of the PPT that benefits should be denied if 'one of the principal purposes' is to obtain the benefit. The formulation suggests that there could be more than one principal purpose and the criticism is that the test should focus on 'the' principal purpose which would lead to a more objective analysis and a more uniform interpretation.<sup>119</sup> The risk is otherwise that the scope on the PPT is unreasonably broad,<sup>120</sup> and according to Lang it will be easier for tax authorities to assume abuse.<sup>121</sup>

The statement in the proposed commentary that the PPT mirrors the existing commentaries 9.5, 22.1 and 22.2 can be questioned since the PPT can be stated to lower the anti-abuse threshold to deny benefits.<sup>122</sup> The proposed commentaries state that "obtaining the benefit under a tax convention need not be the sole or dominant purpose of a particular arrangement or transaction. It is sufficient that at least one of the principal purposes was to obtain the benefit."<sup>123</sup> According to the current commentary 9.5 to article 1, the main purpose should be to obtain the treaty benefit. Consequently the threshold is lowered in the suggested PPT. According to De Broe and Luts it is not acceptable to deny treaty benefits because one of the purposes for the transaction was to obtain the treaty benefit. Tax treaties are treaties of economic nature aimed at encouraging transaction that will occur because of the tax treaty by abolishing tax restrictions. It has to be taken into account that taxes are one of the most important expenditure, therefore it is reasonable that the tax effect will be taken into account when making business decisions.<sup>124</sup>

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<sup>118</sup> Comments received in revised public discussion draft Follow-up work on BEPs action 6: Prevent treaty abuse" June 2015, p. 102-103.

<sup>119</sup> Comments received in revised public discussion draft Follow-up work on BEPs action 6: Prevent treaty abuse" June 2015 p. 79; p. 117; p. 219; p. 319.

<sup>120</sup> Comments received in revised public discussion draft Follow-up work on BEPs action 6: Prevent treaty abuse" June 2015, p. 258.

<sup>121</sup> Lang, M. "BEPS Action 6: Introducing an Antiabuse Rule in Tax Treaties" tax notes international, volume 74, number 7, 2014, p. 659.

<sup>122</sup> De Broe, L. Luts "BEPS Action 6: Tax Treaty Abuse" p. 131.

<sup>123</sup> OECD Action 15: 2015 Final Report p. 58.

<sup>124</sup> De Broe, L. Luts "BEPS Action 6: Tax Treaty Abuse" p. 131.

Another issue with the PPT is the allocation of the burden of proof. Under the current guiding principle in 9.5 Commentary to article 1, the tax authority that want to deny treaty benefits has the burden of proof, both for the subjective and objective test.<sup>125</sup> In the proposed PPT the tax authority has to prove the subjective element at a rather low threshold. To be able to deny treaty benefits it should be ‘reasonable to conclude’ that a motive of gaining a treaty benefit was present. If the tax authority has concluded that one of the principal purposes was to obtain the treaty benefit, the formulation of the PPT indicates that the taxpayer has to establish that obtaining the benefit would be in accordance with the objective and purpose of the treaty. In comparison between the taxpayer and the tax authority, the taxpayer should ‘establish’ that obtaining the benefit is in accordance with the purpose of the treaty and the tax authorities should ‘make reasonable’ that gaining the benefit was one of the purposes which makes the burden of proof unbalanced.<sup>126</sup>

The minimal standard has been criticized for being too vague. According to Pinetz the inclusion in the preamble of the intention to prevent tax avoidance or evasion would have little legal value. Pinetz questions if the preamble has any influence for the interpretation when a specific provisions in the treaty is interpreted, and that by an interpretation of the tax treaty’s relevant provisions consistent with the VCLT the GAAR would be unnecessary.<sup>127</sup>

The implementation of the suggested measures is a crucial part for Action 6, the challenge will most likely be to find a consensus from all states involved.

#### **4.6 Implementation in Action 15**

As stated the key for the BEPS project to succeed is implementation. The BEPS package is intended to be implemented via changes in domestic law and practices, and also through treaty provisions implemented in a multilateral instrument. The suggested measures in Action 6 are intended to be implemented via the multilateral instrument which is the subject of action 15.

Action 15 states that due to increased globalisation some features of current bilateral treaties enable base erosion and profit shifting and need to be addressed.<sup>128</sup> The extensiveness of the tax treaty network makes an update

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<sup>125</sup> De Broe. L. “international tax planning and Prevention of Abuse” p. 394; Arnold. B. “Tax Treaties and Tax Avoidance The revision to the Commentary to the OECD Model, p. 247.

<sup>126</sup> De Broe. L. Luts “BEPS Action 6: Tax Treaty Abuse” p. 132

<sup>127</sup> Pinetz. E.”Final Report on Action 6 of the PECD/G20 Base Erosion and Profit Shifting Initiative: Prevention of Treaty Abuse” p. 119.

<sup>128</sup> OECD Action 15: 2015 Final Report. p. 9.

of the tax treaties very burdensome. The result is a treaty network that is not well synchronised with the OECD MC and arising problems cannot be addressed fast enough. To tackle this problem, governments have agreed to inquire whether it is possible to create a multilateral instrument, resulting in the same effect as renegotiating the existing thousands of bilateral treaties.<sup>129</sup> The goal of Action 15 is therefore to make the implementation of tax treaty related measures more effective. The conclusion of the BEPS reports on Action 15 is that a multilateral instrument is ‘desirable’ and ‘feasible’ and that negotiations for such instrument should be carried out by an ad hoc group. The group is voluntary and open for all interested countries and the multilateral instrument is aimed at being concluded 31 of December 2016.<sup>130</sup>

The report recognizes that the implementation can only be achieved if the tax sovereignty of the states and bilateral specificities are respected. Therefore the states should commit to a set of provisions but also be given the possibility to opt-in or opt-out and choose between alternative provisions. The instrument would co-exist with bilateral tax treaties, and like existing tax treaties the instrument would be governed by international law and legally the instrument would be binding on the parties. The multilateral instrument will modify a limited number of provisions currently included in most existing tax treaties and for some treaties add new provisions that would be specifically designed to counter base erosion and profit shifting.<sup>131</sup> The modified provisions would supersede the existing bilateral provisions regarding the same issue and provisions not covered by the multilateral instrument will remain in force.<sup>132</sup> Due to variations in scope of provisions in existing bilateral treaties problems can arise if the multilateral instrument and the treaty provisions overlap. The potential conflicts between the multilateral instrument and existing treaties is suggested to be solved by inclusion of a specific “compatibility” clause in the multilateral instrument.<sup>133</sup>

#### **4.6.1 Comments on Action 15**

The concerns raised in the light of Action 6 are closely related to Action 15. The suggested provisions would require the consent of all the contracting states. Even if the process would be more effective with a multilateral instrument it still requires the states to accede to the instrument.<sup>134</sup> If one tax treaty do not contain an anti-avoidance provision this could work as a treaty

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<sup>129</sup> OECD Action 15: 2015 Final Report. p.9.

<sup>130</sup> OECD Action 15: 2015 Final Report. p.10.

<sup>131</sup> OECD Action 15: 2015 Final Report. p.20.

<sup>132</sup> OECD Action 15: 2015 Final Report. p.31.

<sup>133</sup> OECD Action 15: 2015 Final Report. p.24.

<sup>134</sup> Follow-up Work on BEPS action 6: Preventing Treaty Abuse, BEPS monitoring group, p.90.

shopping instrument. If countries with special tax treaty networks do not cooperate in implementing Action 6 it could severely undermine Action 6. The opt-in or opt-out possibility suggested in the report to respect state's tax sovereignty and specificities of existing bilateral treaties will weaken the multilateral instrument.<sup>135</sup>

According to Action 15 the aim is to directly change existing tax treaties via the multilateral instrument. All the states signing the multilateral instrument will be legally obligated to implement the measures stated in the multilateral instrument. The solution may seem adaptable when reading the Action 15 report but there are several issues regarding the configuration of the multilateral instrument. The multilateral instrument most likely needs to be reciprocally binding so that both states are bound by the agreement and not only one state signing the multilateral instrument. How to handle such situation needs to be resolved by the ad hoc group.<sup>136</sup>

Another issue is that states have different tax policy goals that the states want to maintain. How the multilateral instrument should be designed to maintain the States tax policy goals and sovereignty, while succeeding in designing a multilateral treaty that the states can agree to, remain to be seen.<sup>137</sup> The OECD recognized that a key for a successful multilateral instrument is to respect the states sovereignty and a way to do this would be to guarantee a level of flexibility in the report, it will be technically demanding to ensure a level of flexibility in the report preserving all the states tax policy goals.<sup>138</sup>

#### 4.7 Summary

The improper use of tax treaties should according to Action 6 be addressed with a SAAR, or a GAAR included in tax treaties. There are several issues regarding the suggested measures, the broad formulation creating legal uncertainty regarding the PPT and the complexity of the LOB. The least extensive suggestion in Action 6 is changes to the title, the preamble and the Commentaries, clarifying that a purpose of tax treaties is not to facilitate tax avoidance or evasion.

The key for BEPS Action 6 to success is implementation, suggested to be executed in a multilateral instrument. The challenge of the multilateral instrument will most likely be to find consensus from all the states on the changes that should be implemented in the multilateral instrument.

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<sup>135</sup> Malherbe. J. "BEPS, The Issues of Dispute Resolution and Introduction Of a Multilateral Treaty" p. 94.

<sup>136</sup> Hultqvist. A. Wiman. B. "BEPS – Implementering i svensk skatterätt" Svensk skattetidning 4, 2015 p. 319; Owens. J. Bravo. N. "BEPS implementation: the role of a multilateral instrument" International tax review, 2015.

<sup>137</sup> Owens. J. Bravo. N. "BEPS implementation: the role of a multilateral instrument" International Tax Review, November 2015.

<sup>138</sup> Owens. J. Bravo. N. "BEPS implementation: the role of a multilateral instrument".

## 5 Implementation in Sweden

### 5.1 Introduction

As the implementation of BEPS would be a key issue for the success of Action 6 the author will look at implementation of Action 6 from a Swedish perspective. Due to the dualistic approach in Sweden there are obligations from two legal sources that must be taken into consideration regarding tax treaties. When entering into a tax treaty Sweden is bound by principles of international law to respect the obligations of the treaty. When the tax treaty is incorporated in the Swedish internal legal order the tax treaty constitutes domestic law.<sup>139</sup>

### 5.2 A Multilateral instrument

According to the constitution only the Swedish Parliament can create tax legislation. Consequently all commitments suggested by the BEPS Action plans require the Parliaments admittance. Changes in existing tax treaties or entering into new treaties also needs the confirmation of the Parliament since the tax treaties need to be incorporated as law in Sweden.<sup>140</sup> Despite the need to adapt to the increasing changes in a more globalized world it is important to keep the constitutional principles and in mind. The Parliament is responsible for the creation of tax law which can be a time consuming process but a way for the principle of legality to be maintained.<sup>141</sup>

Despite all the technical issues regarding the implementation of the multilateral instrument there are examples of multilateral instruments that have succeeded. The convention on mutual administrative assistance is an example of a successful multilateral convention in tax matters. A multilateral treaty has been discussed in academic doctrine. In 2008 a proposal for a mechanism to update tax treaties by Avery Jones and Philip Baker, was considered by the OECD Committee on Fiscal Affairs.<sup>142</sup> At that time there was no political incentive to proceed with the proposal. The BEPS project indicates that it might be possible with a high level of political support to fight the base erosion and profit shifting.<sup>143</sup> On the other hand as stated by many interest groups the Action 6 report indicates that the governments has not been able to agree on several issues and that the report contains many different interests. As for now 90 countries has joined the Ad Hoc group negotiating the multilateral instrument and consequently it will require much further work before or if it can be completed.

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<sup>139</sup> Hultqvist. A. Wiman. B. "BEPS – Implementering i svensk skatterätt" p. 310.

<sup>140</sup> Hultqvist. A. Wiman. B. "BEPS – Implementering i svensk skatterätt" p. 313.

<sup>141</sup> Hultqvist. A. Wiman. B. "BEPS – Implementering i svensk skatterätt" p. 316.

<sup>142</sup> Owens. J. Bravo. N. "BEPS implementation: the role of a multilateral instrument".

<sup>143</sup> Owens. J. Bravo. N. "BEPS implementation: the role of a multilateral instrument".



### 5.3 Changes in the OECD Model Convention

If Action 6 does not lead to the multilateral instrument but changes to the OECD MC, the existing tax treaties need to be renegotiated to be able to include the changes.<sup>144</sup> Sweden has approximately 90 tax treaties which are signed according to the existing version of the MC and will need renegotiation and incorporation. The implementation process is a time consuming process but without renegotiation and incorporation it is only the future treaties that will follow the revised OECD MC.<sup>145</sup>

### 5.4 Changes to the OECD MC Commentaries and the Preamble

The least complex and time consuming outcome of the Action 6 report would be changes to the OECD MC Commentaries. The risk is that it might not be as legally effective as needed. Unlike a modification to the OECD MC, an amendment or change in the Commentaries will not require a renegotiation of existing treaties to ensure that the changes will be legally valid. There are some issues with this approach; first of all it is not certain that a tax treaty concluded before the changes in the Commentaries might be interpreted in accordance with the revised commentary if one of the contracting states uses a static interpretation method. If the Commentaries does not clearly express the common intention of both contracting states when entering into the treaty, an interpretation according to the new Commentaries might not be acceptable according to international law.<sup>146</sup>

From Swedish case law it has been understood that the Swedish courts are using an ambulatory interpretation method, although carefully.<sup>147</sup> Therefore the minimum standard regarding the changes to the Commentaries could be able to be used for an interpretation of the treaty supporting use of a provision against abuse or avoidance. The suggested changes to the Commentaries will most likely keep the question of the legal value of the Commentaries to be debated further.

### 5.5 Constitutional restrictions

Aside from the technical issues that might arise regarding the implementation of Action 6, as recognized in the report, if the suggested measures can or need to be implemented in Sweden. As stated in the Action 6 report there might be constitutional restrictions in a state hindering the implementation of the suggested measures, mainly the LOB or the PPT.

Since an LOB-clause consists in existing tax treaties between Sweden and United States, Poland, Barbados and Japan, the conclusion can be drawn

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<sup>144</sup> Hultqvist. A. Wiman. B. "BEPS – Implementering i svensk skatterätt" p. 317.

<sup>145</sup> Hultqvist. A. Wiman. B. "BEPS – Implementering i svensk skatterätt" p. 319.

<sup>146</sup> Hultqvist. A. Wiman. B. "BEPS – Implementering i svensk skatterätt" p. 320.

<sup>147</sup> In RÅ 1996 ref.84 the latest version of the Commentaries was of importance for the interpretation.

that the LOB-clause is acceptable according to the Swedish constitution. An issue that could hinder the LOB from being implemented in Sweden is the compatibility with EU law. The question is out of the scope of this thesis but must be mentioned since according to the supremacy of EU law, a provision must be compatible with EU and the Treaty of the functioning of the European Union to be able to be implemented in Sweden.

There appears to be no constitutional hinders for the PPT. It could be argued that due to the vague formulation and uncertainty for taxpayers that it could be incompatible with the principle of legality, since the tax system needs to be predictable for taxpayers. Lang states regarding the PTT that “it is hard to ignore the conflict with the legality principle...”<sup>148</sup> The principle of legality requires rules to be clear and the application to be predictable and does not leave decisions to the discretion of the tax authorities and courts. In Sweden the principle of legality demands that an interpretation of tax law cannot be carried out for the disadvantage of the taxpayers. An important part of the legality principle in Sweden is the possibility for taxpayers to be able to predict the consequences of actions.<sup>149</sup> In this regard the PPT could be deficient.

The tax treaty between Sweden and United Kingdom<sup>150</sup> (UK) was recently renegotiated and has included new features inspired by Action 6 and BEPS.<sup>151</sup> For the articles 10, 11 and 12 regarding interest, dividends and royalties a GAAR is implemented similar to the PPT. The GAAR for article 10 in the convention is phrased “No relief shall be available under this Article if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the shares or other rights in respect of which the dividend is paid to take advantage of this Article by means of that creation or assignment.” The article is similar to the PPT but one difference is that the GAAR in the Swedish – UK convention does not provide for the exception that a taxpayer can show that the arrangement or transaction was in line with the object and purpose of the provision. This can be questioned from a perspective of legal certainty and can most likely be questioned from an EU law perspective.<sup>152</sup> The inclusion of the GAAR in the Swedish – UK convention implies that there are no constitutional restrictions for a GAAR in the tax treaties.

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<sup>148</sup> Lang, M. “BEPS Action 6: Introducing an Antiabuse Rule in Tax Treaties” p. 660.

<sup>149</sup> Lodin, S.O. et al. “Inkomstskatt – en läro- och handbok i skatterätt” 13th edition, Studentlitteratur, 2011, p. 723.

<sup>150</sup> Convention between The Kingdom of Sweden and The United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital gains (2015).

<sup>151</sup> For a detailed description of the changes to the treaty see Monsenego, J. “2015 års skatteavtal mellan Sverige och Storbritannien” Svensk Skattetidning 2016:1.

<sup>152</sup> Monsenego, J. “2015 års skatteavtal mellan Sverige och Storbritannien” p. 38-39.

The European Commission has recently released an Anti-Avoidance package including an anti-avoidance provision in the tax treaties similar to the PPT in Action 6. The difference regarding the PPT suggested by the Commission is the subjective part which states that:” 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 provision of this Convention.”<sup>153</sup> The Swedish Government has stated in a memorandum regarding the Commissions suggestion that tax treaties are not a suitable tool for harmonisation between the Member States, since the Member States has to be able to adapt their tax policy to unilateral conditions.<sup>154</sup> This statement is regarding the Commissions suggestion but the same opinion is likely to be upheld regarding the measures suggested to be included in a multilateral instrument in BEPS. On the other hand the tax treaty with UK shows that Sweden is already implementing some of the provisions suggested by BEPS on a bilateral basis.

There are according to the author no constitutional hindrances for the measures suggested in the Action 6 report. The next question is the domestic anti-avoidance provisions makes the suggested measures unnecessary.

## 5.6 The applicability of the Swedish GAAR

As stated in the Action 6 report a state may not need to include the LOB or PTT due to domestic anti-avoidance provisions already preventing abuse of tax treaties and therefore might not be necessary.<sup>155</sup>

According to the case law in Sweden the GAAR and SAARs can be applicable despite a tax treaty if no clear statement has been stated in the tax treaties that it is not the common intention of the contracting parties to apply domestic anti-avoidance rules. This can still be questioned from an international point of view and the principle of *pacta sunt servanda* since the interpretation of the Swedish Administrative Court requires no statement that the use of domestic anti-avoidance rules is the intention of the contracting states. For this interpretation to be accepted in accordance with international law and the VCLT the purpose and object to prevent tax avoidance or evasion should be able to be found in the text or context of the tax treaty. Since the legal value of the OECD Commentaries are not generally accepted as source of interpretation, an interpretation according to the Commentaries might to be applied by all contracting states. The interpretation of the Swedish Administrative Court can therefore still

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<sup>153</sup> European Commission “Final Commission Recommendation of 28.1.2016 on the implementation of measures against tax treaty abuse” Brussel 2016, p. 3.

<sup>154</sup> Regeringskansliet Faktapromemoria “Meddelande om skatteflykt respektive effektiv beskattning samt rekommendation om missbruk av skatteavtal” Finansdepartementet, 2016, p. 9.

<sup>155</sup> OECD, Action 6 – 2015 Final Report, p. 14.

constitute treaty override and be questioned from a legal certainty perspective. A risk is that the contracting state might make different interpretations of the tax treaty and that the taxpayer instead will suffer from double taxation, which hindrance has been the primary purpose of tax treaties.

The interpretation of the Highest Administrative Court could be seen as questionable from international point of view. But the interpretation constitutes current law in Sweden. Therefore the PPT might not need to be included in the Swedish tax treaties since the Swedish GAAR can apply to the situations that otherwise the PPT would have been applicable on. A comparison of the PPT and the Swedish GAAR shows that the provisions have to a great extent the same scope. The subjective assessment in the PPT states that a benefit should be denied if it is reasonable to conclude that one of the principal purposes of the arrangement or transaction was to obtain the tax benefit. The Swedish GAAR can be applied if the transaction result in a significant tax benefit for the taxpayer and that the tax benefit is assumed to have been the predominant reason for the transaction. Further the PPT states that the benefits of the treaty should be denied, if it cannot be established that granting the benefits would be in accordance with the object and purpose of the convention. The Swedish GAAR states that the transaction should be disregarded for taxation purposes, if taxation on the basis of the transaction would be in violation with the purpose of the law. The formulation varies since the PPT is formulated as an exception, and the Swedish GAAR is formulated as another requirement, but both provisions contain the objective assessment of the purpose of the provision. As the Swedish GAAR can be applied to situations covered by a tax treaty, the Swedish GAAR could be applied in the same way as the PPT is intended to.

Therefore the PPT might not be necessary in the Swedish tax treaties. Despite criticism from academics in Sweden that the Swedish GAAR leads to legal uncertainty, the Swedish GAAR appears to create more legal certainty than the PPT. Both rules give rise to subjective assessments, but the formulation of the PPT is broader in comparison with the Swedish GAAR. The GAAR states that the ‘predominant purpose’ of the transaction should be the tax benefit whereas the PPT only requires the benefit to be ‘one of the main purposes’ of the transaction. The ‘predominant purpose’ can reflect the ‘main purpose’ as stated in the OECD MC Commentaries stated to be broadened in Action 6. Further the Swedish GAAR places the burden of proof mainly on the Tax Agency for both the subjective and objective assessment, unlike the PPT where the burden of proof for the objective test is placed on the taxpayer. Therefore the Swedish GAAR would result in more legal certainty for the taxpayer. Further, according to the suggested changes to the Commentaries the contracting states “should carefully observe the specific obligations enshrined in tax treaties to relieve

double taxation as long as there is no clear evidence that the treaties are being abused.”<sup>156</sup> The statement in the Commentaries clearly requires a higher threshold demanding clear evidence of abuse unlike the PPT, where the threshold for the tax authorities is “reasonable to conclude”.

Lang is of the opinion that the PPT does not have any independent legal significance, as the PTT simply underlines the already apparent need for an interpretation according to the object and purpose of the provisions.<sup>157</sup>

The minimal standard suggested in BEPS includes a statement in the preamble clarifying that the purpose of tax treaties is to prevent tax evasion or avoidance. The statement would more clearly express prevention of tax avoidance or evasion as one of the primary purposes of a tax treaty. Consequently the prevention of tax avoidance or evasion could be interpreted as the common intention of the contracting states. An interpretation to use domestic anti-avoidance rules would be more in conformity with an interpretation according to the object and purpose in VCLT article 31.1. Accordingly this would support the Swedish Highest Administrative Court’s judgment and make their legal standpoint more in compliance with international law.

An issue that could arise regarding the minimum standard is that the purpose of preventing tax avoidance or evasion can conflict with the purpose of preventing double taxation. The question is which purpose should prevail. The Swedish Anti-Avoidance Act can never be applied by the Tax Agency themselves but has to be assessed by the Administrative Court. Therefore this question would have to be solved by the Administrative Courts in Sweden, as opposed to the PPT which will allow the Tax Agency to apply the PPT to deny treaty benefits. Consequently the Administrative Court would make the assessment of which purpose should prevail. The Highest Administrative Court has in cases of interpretation of tax treaties accepted both double taxation and non-double taxation as the result.<sup>158</sup>

## 6 Conclusion

The relationship between tax treaties and domestic anti-abuse rules has been subject to discussion. The issue of tax treaty overrides being a prohibited practice according to international law, conflicts with the purpose of preventing abuse or avoidance. According to the OECD MC Commentaries a contracting state can use its domestic anti-avoidance rules if there is clear evidence that a transaction constitutes abuse. As indicated by need to

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<sup>156</sup> OECD Action 6 p. 85.

<sup>157</sup> Lang. M. ”BEPS Action 6: Introducing an Antiabuse Rule in Tax Treaties” p. 661.

<sup>158</sup> RÅ 2001 ref. 46 and RÅ 1996 ref. 84; Hilling. M. ”HFD:s Peru-domar” p. 584.

address treaty abuse and treaty shopping in BEPS Action 6, the Commentaries are not sufficient to combat abusive practices. A reason can be that the Commentaries are not binding on the contracting states and the purpose to prevent abuse has only been seen as an ancillary purpose of tax treaties.

The PPT would include a subjective assessment by tax authorities that could differ between the contracting states and create legal uncertainty. The risk for different interpretations of the PPT in the contracting states could adversely affect international trade and undermine the international tax system.

The LOB on the other hand, due to its rule based nature would create legal certainty provided that a taxpayer can manage the complexity of the rule. As stated above the LOB is possible from a constitutional perspective, although perhaps not according to EU law, but it is doubtful that the clause if needed from a Swedish perspective. Some of the suggested provisions appear to be formulated for US purposes and this provision might be more suitable for a bilateral treaty.

The anti-abuse provisions suggested in Action 6 is only a few of the anti-abuse provisions recently introduced or suggested. The danger with this 'trend' is that the risk for double taxation increases. In the authors opinion the new Swedish - UK tax treaty is an example of measures introduced that might be to far-reaching and create legal uncertainty for the taxpayer.

From a Swedish perspective the inclusion of an LOB and a PPT in the tax treaties is according to the author not necessary. The interpretation by the Highest Administrative Court states that, if the treaty does not express that the intention of the contracting states is not to use domestic anti-avoidance provision, the use of domestic anti-avoidance rules are accepted. Since this interpretation can be questioned from the perspective of international law, the minimal standard suggested in Action 6 is necessary. By an inclusion in the preamble that a purpose of the tax treaty is to prevent tax avoidance or evasion the interpretation of the Swedish Administrative Court will be in accordance with the interpretation according to the object and purpose as stated in article 31 VCLT. The Swedish domestic Anti-Avoidance Act will therefore be sufficient to prevent improper use of a tax treaty.

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