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OECD Base Erosion and Profit Shifting Action 6: The General Anti-Abuse Rule

In this article, the author examines Action 6 of the OECD Base Erosion and Profit Shifting (BEPS) initiative, with special regard for the proposed general anti-abuse rule (GAAR). In the author's opinion, although some of the criticism raised against it is justified, the proposed rule is in line with similar rules in comparative law.

1. The General Anti-Abuse Rule and BEPS Action 6

Action 6 of the BEPS initiative has the following three purposes:
(1) preventing the granting of treaty benefits in inappropriate circumstances;
(2) clarifying that tax treaties are not intended to be used to generate double non-taxation; and
(3) identifying the tax policy considerations that states should consider before deciding to enter into a tax treaty.

The 2014 OECD report *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* ("the Report")[1] sets out the results of work carried out in these three areas. The Report dedicates the most attention to the first objective, and the recommendations in this regard constitute the bulk of the Report. Introducing a general anti-abuse rule (GAAR) into tax treaties is an important recommendation in this area, and a very striking one at that. Before analysing this proposal, it is important to place it in the context of the general system of measures proposed in the Report to counter treaty abuse.

These measures are based on the distinction between the following two types of treaty abuse:
(1) where a person tries to circumvent the limitations set out in the tax treaty itself; and
(2) where a person tries to circumvent the provisions of domestic tax law using treaty benefits.

The first type of treaty abuse, the "granting of treaty benefits in inappropriate circumstances", consists in the first place of situations generally referred to as "treaty shopping", i.e. cases in which a person who is not a resident of a contracting state and is, therefore, not entitled to the benefits of a tax treaty tries to access these benefits indirectly. Treaty shopping is the form of abuse to which the Report gives the greatest attention, although the Report also considers other situations in which a person tries to circumvent treaty limitations, for example, when a company that holds less than 25% of the capital of the company that distributes the dividends and is therefore only entitled to the 15% withholding tax rate under article 10(2)(b) of the OECD Model[2] acquires immediately before the distribution the necessary additional participation to reach the 25% limit necessary to benefit from the 5% withholding tax under article 10(2)(a). These situations are usually referred to as "rule shopping". According to the Report, although the GAAR will be useful in addressing such situations, targeted anti-abuse rules (TAARs) or specific anti-abuse rules (SAARs) generally provide greater certainty for both taxpayers and tax authorities. These rules can already be found in some articles of the OECD Model, for example article 13(4) regarding the alienation of shares deriving more than 50% of their value, directly or indirectly, from immovable property situated in the other contracting state, and article 17(2) on income in respect of personal activities exercised by an entertainer or a sportsman in his capacity as such [that] accrues not to the entertainer or sportsman himself but to another person. The Commentaries on the OECD Model[3] also suggest the inclusion of other anti-abuse provisions.

The second form of treaty abuse consists of the circumvention of domestic tax law provisions through the use of treaty benefits. As De Broe and Luts (2015)[4] aptly put it, this can arise when (i) an abuse of a domestic law provision is dealt with by (ii) a domestic GAAR, SAAR or judicial doctrine, subsequent to which (iii) treaty protection is invoked by the taxpayer to make the rule or doctrine inapplicable. Ex ante, this form of treaty abuse only involves the avoidance of domestic law, independent of the application of a tax treaty. Consequently, these cases can only be countered by domestic anti-abuse rules. However, as taxpayers invoke the protection of tax treaty provisions to neutralize the application of domestic anti-abuse rules, a relevant issue is the interaction between treaty and domestic rules.

The Commentary on Article 1 of the OECD Model (2003)[5] adopts the position that:

> [a] guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for

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1. OCED, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* (OECD 2014), International Organizations' Documentation IBFD.
2. Most recently, *OECD Model Tax Convention on Income and on Capital* (15 July 2014), Models IBFD.
3. Most recently, *OECD Model Tax Convention on Income and on Capital: Commentaries* (15 July 2014), Models IBFD.
4. L. De Broe & J. Luts, *BEPS Action 6: Tax Treaty Abuse*, 43 Intertax 2, p. 135 (2015).
5. *OECD Model Tax Convention on Income and on Capital: Commentaries* (28 Jan. 2003), Models IBFD.

> entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.[6]

The Commentary on Article 1 of the OECD Model also adds that domestic judicial anti-abuse doctrines, such as "substance over form" and "economic substance", and GAARs:

> are part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability; these rules are not addressed in tax treaties and are therefore not affected by them. Thus, as a general rule... there will be no conflict [between them and tax conventions].[7]

The Report states that the incorporation of these guiding principles into tax treaties through the new GAAR does not modify the conclusions reflected in the Commentary on Article 1 of the OECD Model regarding the interaction between tax treaties and domestic anti-abuse rules, and proposes to clarify this position by adding new paragraphs to the OECD Commentary on Article 1.[8] However, the position of the OECD Commentary on Article 1 may not be followed by national courts in cases where it is doubtful whether a tax treaty does, in fact, conflict with domestic anti-abuse provisions.

In view of these possibilities, the Report advises the adoption of a "saving clause" in the OECD Model, following the long-standing practice of the United States, by inserting a new article 1(3), according to which a tax treaty should not affect the taxation by a contracting state of its residents, not its citizens as in the United States, with the exception of certain specific benefits. By virtue of this clause, the application of a domestic anti-abuse rule should not be prevented as a consequence of a treaty provision.

With regard to treaty shopping, the Report recommends the adoption of the following three measures, i.e. the "three-pronged approach":

(1) including in the title and the preamble of tax treaties a statement to the effect that the contracting states wish to prevent tax avoidance and, in particular, avoid creating opportunities for treaty shopping;
(2) including in tax treaties an anti-abuse rule based on the limitation on benefits provision (the "LOB provision") included in US tax treaties; and
(3) adding to tax treaties a GAAR based on the principal purposes of transactions or arrangements, i.e. the "principal purpose test" rule (the "PPT rule").

The Report acknowledges that, although some flexibility is possible, "at a minimum" states should agree to include in their tax treaties the express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements, and states should implement that common intention by way of either the "combined approach" of both the LOB provision and the PPT rule or the inclusion of one of these rules supplemented by a mechanism designed to counter "conduit arrangements", such as that suggested in paragraph 15 of the Commentary on the PPT rule.

The PPT rule would not constitute a separate article of the OECD Model but would form paragraph 7 of the as yet unnumbered article X, entitled "Entitlement of benefits", the first six paragraphs of which set out the LOB provision. This placement is systematically questionable given the different nature of both rules.

2. The PPT Rule

2.1. The PPT rule in comparative perspective

The proposed PTT rule would read as follows:

> 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.

The proposed treaty provision has substantial similarities with other modern GAARs that base the definition of abuse on the purpose of the transaction, i.e. a transaction is abusive if its main purpose, or one of its main purposes, is to obtain an unjustified or illegitimate tax advantage, or, in the OECD's words, a treaty benefit "[not] in accordance with the object and purpose of the relevant provisions of [the] Convention". For instance, according to the UK GAAR, established by Part 5 of the Finance Act (2013), arrangements are "tax arrangements":

> if, having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangement [and that] tax arrangements are "abusive" if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant provisions.

The US anti-abuse rule introduced in section 7701 of the Internal Revenue Code introduced by the Health Care and Education Reconciliation Act of 2010 under the heading "codification of economic substance doctrine" establishes that a transaction has economic substance if it:

> changes in a meaningful way... the taxpayer's economic position [and] the taxpayer has a substantial purpose (apart from Federal Income Tax effects) for entering into such transaction.

According to the Act, "the term 'economic substance doctrine' means the common law doctrine under which tax benefits [granted by the law] are not allowable if the transaction does not have economic substance or lacks a business purpose".

Such a rule highlights the profound relationship between the purpose of the transaction and its economic substance. This is a relationship that is at the core of the economic substance and other judicial anti-avoidance doctrines, such as "substance over form" or "business purpose" doctrines. Similarly, the Canadian GAAR, in section 245 of

6. Para. 9.5 *OECD Model: Commentary on Article 1* (2014).
7. Id., at para. 22.1.
8. OECD, *supra* n. 1, at m.n. 49. *See also* the critical comments of De Broe & Luts, *supra* n. 4, at p. 136.

the Income Tax Act, defines "avoidance transaction" as a transaction that results:

> directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit.

There is a remarkable similarity between the OECD formula and that chosen by the European Union for its GAARs in the context of countering "aggressive tax planning", a policy that runs parallel to that of the G20 and the OECD BEPS initiative. In its Recommendation on aggressive tax planning (2012/772/EU) of 6 December 2012, the European Commission advises the Member States to introduce into their national legislations the following GAAR:

> An artificial arrangement or an artificial series of arrangements which has been put into place for the essential purpose of avoiding taxation and leads to a tax benefit shall be ignored. National authorities shall treat these arrangements for tax purposes by reference to their economic substance.

The Commission clarifies the terms of the definition and, inter alia, indicates that "an arrangement or a series of arrangements is artificial where it lacks commercial substance" and suggests that, in determining whether an arrangement is artificial, it should be considered whether the arrangement involves one or more of the situations referred to, such as being "inconsistent with the legal substance of the arrangement as a whole" or being "carried out in a manner which would not ordinarily be employed in what is expected to be a reasonable business conduct".

In the context of countering aggressive tax planning, the Council of the European Union has also recently adopted Directive 2015/121 of 27 January 2015,[9] amending the Parent-Subsidiary Directive (2011/96),[10] to replace the original anti-avoidance provision in article 1(2), which remitted to national law, with a new anti-abuse clause in the following terms:

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

2.2. Criticisms on the proposed PPT rule

The OECD proposed definition of an abusive transaction with regard to a treaty PPT rule has been criticized. A frequent criticism refers to the requirement that obtaining the (unjustified) treaty benefit must be only "one of the principal purposes" of the arrangement.[11] Paragraph 12 of the Commentary on the PTT rule makes this clear by stating that:

> [t]he reference to "one of the principal purposes" in paragraph 7 means 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.

De Broe and Luts (2015)[12] consider this unacceptable. In their opinion, the rule should only be applied if treaty benefits are the only or predominant purpose of the transaction. Similar criticism has been made by other authors.[13] It has also been noted that, in this respect, the PPT rule might contradict the concept of abuse as held by the Court of Justice of the European Union (ECJ), according to which obtaining the tax advantage has to be the "essential aim" of the transaction.[14] It must be admitted that this criticism has considerable weight, despite the fact that the amended Parent-Subsidiary Directive (2011/96) uses the same expression ("one of the main purposes"). As Lang (2014) notes, in the European Union the ECJ has the monopoly regarding the interpretation of EU legislation, whereas tax treaties are interpreted by national courts, which can hold completely diverging opinions.

The opinion of the various critics to the effect that the rule should be interpreted in the sense that obtaining the treaty benefit must be the principal purpose of the arrangement, not just one of the principal purposes, finds some (feeble) support in paragraph 10 of the Commentary on the PPT rule, according to which the rule's condition is met if "an arrangement can only be reasonably explained by a benefit that arises under a treaty". However, this falls short of affirming that only then is the condition met.

Paragraph 13 of the Commentary on the PTT rule states that:

> [w]here... an arrangement is entered into for the purpose of obtaining similar benefits under a number of treaties, it should not be considered that obtaining benefits under other treaties will prevent obtaining one benefit under one treaty from being considered a principal purpose for that arrangement.

In other words, the relative weight of the benefit under a specific tax treaty compared to the global benefits of the arrangement is irrelevant in determining whether obtaining such benefit was the main purpose of the arrangement for purposes of that tax treaty.

A further criticism relates to the burden of proof. According to paragraph 10 of the Commentary on the PTT rule, in determining whether one of the principal purposes of the transaction is to obtain benefits under the tax treaty:

> [i]t is not necessary to find conclusive proof of the intent of a person concerned with an arrangement or transaction, but it must be reasonable to conclude, after an objective analysis of the relevant facts and circumstances, that one of the principal purposes of the arrangement or transaction was to obtain the benefits of the tax convention.

This standard, i.e. "reasonable to conclude", is confronted by that imposed on the taxpayer, who, according to para-

9. Council Directive (EU) 2015/121 of 27 January 2015 Amending Directive 2011/96/EU on the Common System of Taxation applicable in the case of Parent Companies and Subsidiaries of Different Member States, OJ L21/1 (2015), EU Law IBFD.
10. Council Directive 2011/96/EU of 30 November 2011 on the Common System of Taxation applicable in the case of Parent Companies and Subsidiaries of Different Member States, OJ C107 (2011), EU Law IBFD.
11. The Discussion Draft uses the word "main" instead of "principal", a change that does not seem to have any significance.
12. De Broe & Luts, *supra* n. 4, at p. 132.
13. M. Lang, *BEPS Action 6: Introducing an Antiabuse Rule in Tax Treaties*, 74 Tax Notes Intl. 7, p. 659 (2014).
14. E.C.C.M. Kemmeren, *Where is EU Law in the OECD BEPS Discussion?*, 23 EC Tax Rev. 4, p. 192 (2014).

graph 2 of the Commentary on the PTT rule, must "establish" that obtaining the benefit would be in accordance with the object and purpose of the relevant provisions of the convention.[15] However, in view of the GAARs referred to in section 2.1., it is questionable whether the "reasonability" standard implies a lesser burden of proof on the part of the tax authorities. Doubts in this regard should, nevertheless, be dispelled, as the burden of proof must undoubtedly ultimately fall on the tax authorities.

It has also been critically noted that the "subjective element" of the PPT rule, i.e. the "purpose" of obtaining the treaty benefit, is linked to an arrangement or transaction rather than to a person, i.e. the taxpayer. Consequently, the rule could be invoked against a third party only indirectly involved in the transaction.[16] It may, however, be that the "purpose test" is not so subjective after all, as the purpose must be inferred from characteristics of the transaction, such as its "artificiality", its "lack of economic substance" or the fact that it does not have a valid commercial purpose. These characteristics are evident in various forms in the GAARs found in comparative law. It is the arrangement itself that is fiscally unacceptable, regardless of the parties that may be affected. In other words, the abusive nature is not a quality pertaining to the will of a party to the transaction, but rather a legal attribute of the transaction itself.

Some rather tenuous references to the "economic substance" or "valid commercial purposes" criteria can be found in the Commentary on the PTT rule. Specifically, paragraph 6 of the Commentary on the PTT rule affirms that:

> [t]he provision is intended to ensure that tax conventions apply in accordance with the purpose for which they were entered into, i.e. to provide benefits in respect of bona fide exchanges of goods and services, and movements of capital and persons as opposed to arrangements whose principal objective is to secure a more favourable tax treatment.

Similarly, paragraph 13 of the Commentary on the PTT rule states that:

> where an arrangement is inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit, it is unlikely that its principal purpose will be considered to be to obtain that benefit.

Commenting on an example, paragraph 8 of the Commentary on the PTT rules indicates that a loan was entered into "for valid commercial reasons" but transferred to a subsidiary in another state mainly for tax purposes, which entails the application of the PPT rule. These references to economic substance or valid commercial purposes as (negative) elements of the PPT rule should be reinforced.

2.3. The relationship with SAARs

Two other aspects of the proposed PPT rule must be considered. The first is its relationship with SAARs in a tax treaty. This is a basic question regarding the application of GAARs. The PTT rule states that it applies "notwithstanding the other provisions of this Convention". Paragraphs 3 and 4 of the Commentary on the PTT rule explain the meaning of this phrase with regard to the LOB provision, i.e. the PPT rule:

> supplements and does not restrict in any way the scope or application of the provisions of paragraphs 1 to 6 (the limitation-on-benefits rule): a benefit that is denied in accordance with these paragraphs is not a "benefit under the Convention" that paragraph 7 would also deny.

In other words, if one of the objective conditions of the LOB provision, for example to be a "qualified person", is not met, benefits under a tax treaty should be denied whether or not the envisaged transaction is caught by the PPT rule. This is the normal way in which SAARs function, i.e. the denial of the pursued tax advantage under the specific rule makes recourse to the general rule unnecessary.

More relevant is that, as paragraph 4 of the Commentary on the PTT rule continues:

> [c]onversely, the fact that a person is entitled to benefits under paragraphs 1 to 6 does not mean that these benefits cannot be denied under paragraph 7.

That is to say that, even if the conditions of the LOB provisions are met, for example, the taxpayer is a "qualified person", the treaty benefit may be denied if the transaction meets the requisites of the GAAR. The opposite solution is adopted by some tax legislations, including section 42 of the German General Tax Code (*Abgabenordnung*), as amended in 2008, which gives preference to the application of SAARs. This rule offers greater security to taxpayers and is less favourable to the tax authorities. De Broe and Luts (2015) criticize the OECD's proposed solution on the grounds of the principle *lex specialis derogat legi generali*. Consequently, in these authors' opinion:

> once a purported abusive arrangement passes [the] SAARs, the PPT should only apply *to the extent* the allegedly abusive behaviour is completely out of the scope of the type(s) of treaty abuse the SAARs intend to counter.[17] (Emphasis added)

It is, however, doubtful that the relationship between a GAAR and a SAAR is the same as the relationship between a general norm and a special norm contemplated in the *lex specialis derogat legi generali* maxim. The similarity of the terms is misleading: a SAAR is not a specific case of a GAAR, i.e. the hypothesis of the GAAR does not include the hypothesis of the SAAR; rather, they are independent rules with separate legal hypotheses. The GAAR is "general" in the sense that it is destined to counteract all kinds of avoidance transactions, whereas a SAAR is meant to combat a specific avoidance transaction. This being the case, choosing between the two solutions is a policy issue that must be discussed.[18]

2.4. Consequences of the PTT rule

The second aspect of the proposed PPT rule is its consequence. Such consequence is that "a benefit under this Convention shall not be granted". Accordingly, the "benefit" is part of both the hypothesis of the rule, i.e. "the purpose of obtaining the benefit", and its consequence, i.e.

15. De Broe & Luts, *supra* n. 4, at p. 133; Lang, *supra*, n. 13, at p. 659.
16. Id.
17. Id., at p. 133.
18. Rather in terms of policy, *see* Lang, *supra* n. 13, at p. 658.

the denial of the pursued benefits. Obviously, the benefits contemplated are only those under the tax treaty that includes the PPT rule, and not under any other legislation or treaty. In other words, the rule is intended to counter abuse of a particular tax treaty. According to paragraph 7 of the Commentary on the PTT rule:

> [t]he term "benefit" includes all limitations (e.g. a tax reduction, exemption, deferral or refund) on taxation imposed on the State of source under Articles 6 through 22 of the Convention, the relief from double taxation provided by Article 23, and the protection afforded to residents and nationals of a Contracting State under Article 24 or any other similar limitations.

Therefore, it does not include the scope of the tax treaty, i.e. articles 1 and 2 of the OECD Model and the definitions in articles 3 to 5, which do not confer a benefit on their own, but only in connection with the distribution rules. Some authors are, unsurprisingly, perplexed by the consideration of the protection from non-discrimination under article 24 of the OECD Model as a benefit that can be abusively invoked.[19]

The denial of the benefits derived from the abused provision is the universal consequence of GAARs. However, once this negative conclusion has been established, the question arises as to the adequate tax treatment of the arrangements or transactions designed to obtain the refused benefit. Most legislations simply ignore this problem or refer to it in excessively vague terms. This is the case of article 15(3) of the Spanish General Tax Law (*Ley General Tributaria*), which establishes that, as a consequence of the GAAR contained in the article, tax should be assessed by applying the provision that corresponds to the adequate transactions or by eliminating the obtained fiscal advantage. Similarly, the GAAR rule as proposed by the European Commission (*see* section 2.1.) simply determines that "national authorities shall treat [artificial] arrangements for tax purposes by reference to their economic substance". The Canadian GAAR (*see* section 2.1.) provides that the tax consequences of denying a benefit that would result, but for the rule, directly or indirectly, from an avoidance transaction should be determined according to what is reasonable in the circumstances. For this purpose, this law grants the tax authorities ample power to allow or disallow deductions or exemptions, to allocate these to any person, to recharacterize payments or amounts, or to ignore the tax effects that would otherwise result from the application of other provisions of the Canadian Income Tax Act.

Section 209 ("Counteracting the tax advantages") of the UK Finance Act (2013) in relation to the UK GAAR establishes, inter alia, that:

> [t]he adjustments required to be made to counteract the tax advantages are such as are just and reasonable, [that] [t]he adjustments may be made in respect of the tax in question or any other tax to which the general anti-abuse rule applies [and that these include] those that impose or increase a liability to tax in any case where (ignoring this Part) there would be no liability or a smaller liability, and tax is to be charged in accordance to such adjustment.

Section 210 of the UK Finance Act (2013) also envisages "consequential relieving adjustments... as are just and reasonable", which may be made in respect of any period and which may affect any person, whether or not party to the tax arrangements, but cannot increase a person's liability to tax.

As a result, comparative law demonstrates that, apart from the basic affirmation that the intended tax benefits are not admitted, the question of the consequences of a GAAR are either ignored or dealt with by granting the tax authorities ample discretional powers to determine such consequences. The proposed PPT rule in Action 6 opts for the silence alternative, i.e. neither the PTT rule itself nor the Commentary on the PTT rule offer any guidance in this respect. This omission has been criticized.[20]

One relevant question that is not addressed by the PTT rule or its commentary is the effect in the residence state of the application of the PTT rule by the source state. If, for example, on the basis of the PPT rule, the source state recharacterizes a payment as interest instead of dividends, thereby increasing its withholding tax powers, should the residence state credit the higher amount withheld? The residence state should do so if it considers that the PPT rule was correctly applied by the source state. But what if the residence state disagrees with the application of the PTT rule? In this case, the dispute, which refers to the interpretation of the PPT rule, could only be resolved through a mutual agreement procedure (MAP). This is similar to a discrepancy concerning the corresponding adjustment of profits of associated enterprises[21] or to a conflict of qualification.[22]

Obviously, the case is more complicated in situations involving three or more states, as noted by Lang (2014), who postulates the following dilemma: either the PTT rule is an order to abolish specific treaty benefits in *one* state, and then it leads to double taxation and has penalizing effects, or it creates a fiction that goes beyond the arrangement considered appropriate. If the latter alternative is chosen, the question next arises as to "how far this fiction reaches and when it will be replaced again by the real facts". Lang (2014) adds that "[r]eestablishing the actual facts of taxation will lead to seemingly arbitrary and thus unsatisfactory consequences".[23]

In the author's opinion, this dilemma is not unavoidable, i.e. the PPT rule neither necessarily results in double taxation nor does its application give rise to a fiction. The application of a GAAR, whether internal or international, demands the reconfiguration of the tax treatment of the arrangement on the basis of the situation that corresponds to its economic substance, as provided for by the GAAR as proposed in the European Commission's Recommendation, and not in the form in which it was construed for avoidance purposes. The remarks of Lang (2014) reflect an

19. De Broe & Luts, *supra* n. 4, at p. 131 and Lang, *supra* n. 13, at p. 657.
20. De Broe & Luts, *supra* n. 4, at p. 133 and Lang, *supra* n. 13, at p. 661.
21. Art. 9(2) *OECD Model* (2014) and para. 11 *OECD Model: Commentary on Article 9* (2014).
22. Para. 32.5 *OECD Model: Commentary on Articles 23A and 23B* (2014).
23. Lang, *supra* n. 13, p. 662 and the example that that author sets out.

attitude of clear opposition to GAARs, in general, which the author considers in section 2.5.

2.5. Conformity with EU law

Concerns have been raised as to the conformity of the PPT clause with EU law. The doubts of Kemmeren (2014) regarding the fact that the rule only requires that obtaining the benefit be "one of the principal purposes" of the arrangement was considered in section 2.2. Kemmeren (2014) notes that the expression "it is reasonable to conclude" may give rise to too great an uncertainty for taxpayers, which would not be acceptable to the ECJ in light of the "principle of legal certainty".[24] Nevertheless, it is worth recalling that the UK GAAR uses exactly the same expression and that the Canadian GAAR also employs the "reasonability" standard.

Dourado (2015)[25] finds coincidences and divergences between the PPT rule and EU law. With regard to coincidences, Dourado (2015) notes that the rule includes the two *Halifax* (Case C-255/02)[26] elements of the abuse of law principle in EU law, i.e. (i) whether the tax benefit granted is in accordance with the object and purpose of the relevant provisions in the tax treaty, and (ii) whether obtaining the tax benefit was one of the principal purposes of any arrangement or transaction. The expression "one of the principal purposes" corresponds, at least formally, to the "main purpose or one of the main purposes" in *Cadbury Schweppes* (Case C-196/04)[27] and to "one of the main purposes" in the EU Merger Directive (2009/133);[28] however, Dourado (2015) remarks that "one of the principal purposes" is broader than the "sole purpose" as results from some ECJ case law or the "essential purpose" as results from *Halifax* and that is proposed in paragraph 4.2 of the European Commission Recommendation on aggressive tax planning.

Dourado (2015) also notes the following differences from the EU principle of abuse and from the proposed GAAR in the European Commission Recommendation on aggressive tax planning. First, with regard to the PPT rule, if obtaining the tax benefit is one of the principal purposes of the arrangement or transaction, there is a presumption that the tax benefit is not in accordance with the object and purpose of the treaty provision. In the opinion of Dourado (2015), such a presumption would most probably be contrary to the fundamental freedoms, i.e. it would be disproportionate.

Second, there is no reference to "artificiality" or "normal commercial operations" in the PPT rule. However, one example in paragraph 8 of the Commentary on the PTT rule refers to "valid commercial reasons" without defining this.

Third, paragraph 6 of the Commentary on the PTT rule refers to "bona fide exchanges" of goods and services and movements of capital and persons as opposed to arrangements for which the principal objective is to obtain a tax advantage. However, in the opinion of Dourado (2015), it is at the very least dubious that a bona fide analysis is adequate to determine tax avoidance or abuse, and the use of such broad principles as the bona fide principle does not reduce vagueness and legal uncertainty.[29]

Fourth, in the examples of abuse used in the Commentary on the PPT rule, either a third state comes into play so that a tax benefit is obtained, or the taxpayer transfers residence shortly before entering into a transaction. If a Member State applied a PPT rule to the latter situation, there would be a restriction to a fundamental freedom.

The conclusions of Dourado (2015) are that:

> [t]aking into account the aforementioned differences between the PPT rule and the EU principle of abuse, if the PPT rule designed were to be included in tax treaties by EU Member States, some issues of incompatibility with EU law could be raised.[30]

However, as Dourado (2015) notes, Action 6 already foresees this possibility and repeatedly states that the proposed provisions are model provisions that will have to be adapted to the specificities of individual states and, inter alia, to "constitutional or EU law restrictions that prevent them from adopting the exact wording of the model provisions that are recommended in this report".[31] In the opinion of Dourado (2015), the new GAAR introduced in the Parent-Subsidiary Directive (2011/96) combines the elements of the PPT rule in Action 6 and the artificiality test as required by the ECJ and proposed in the European Commission Recommendation on aggressive tax planning. As a result, Dourado (2015) aptly suggests that the GAAR in the Parent-Subsidiary Directive (2011/96) could be used as standard for the PPT rule if introduced by the Member States into their tax treaties.

3. Concluding Remarks

An inherent principle of every legal system, past and present, is the rejection of the abuse of its norms. All systems have developed techniques to prevent their rules from being artfully circumvented. The ECJ has held that prevention of abuse is a general principle of EU law, although this is theoretically controversial. Once ratified, tax treaties become part of the law of the contracting states,

24. Kemmeren, *supra* n. 14, at p. 192, who cites PT: ECJ, 3 Oct. 2013, Case C-282/12, *Fazenda Pública v. Itelcar – Automóveis de Aluguer, Lda*, ECJ Case Law IBFD.
25. A.-P. Dourado, *Aggressive Tax Planning in EU Law and in the Light of BEPS: The EC Recommendation on Aggressive Tax Planning and BEPS Actions 2 and 6*, 43 Intertax 1, p. 55 et seq. (2015).
26. UK: ECJ, 21 Feb. 2006, Case C-255/02, *Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v. Commissioners of Customs & Excise, BUPA Hospitals Ltd, Goldsborough Developments Ltd v. Commissioners of Customs and Excise and University of Huddersfield Higher Education Corporation v. Commissioners of Customs and Excise*, ECJ Case Law IBFD.
27. UK: ECJ, 12 Sept. 2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, ECJ Case Law IBFD.
28. Council Directive 2009/133/EC OF 19 October 2009 on the Common System of Taxation applicable to Mergers, Divisions, Partial Divisions, Transfers of Assets and Exchanges of Shares Concerning Companies of Different Member States and to the Transfer of the Registered Office of an SE Or SEE Between Member States (as amended through 2013), OJ L310 (2009), EU Law IBFD.
29. *See*, however, the Canadian GAAR noted in section 2.2.
30. Dourado, *supra* n. 25, at p. 56.
31. OECD, *supra* n. 1, at para. 6. The reserve is repeated in para. 13.

even if their interpretation and application has to take into account the common will of the treaty parts.

GAARs are an indispensable tool against the abuse of tax law, as the evolution of comparative law highlights. Countries, such as the United Kingdom, the legal culture of which has traditionally been reluctant to adopt this technique, have enacted a GAAR, as has the European Union, which, in addition to introducing a GAAR in the Parent-Subsidiary Directive (2011/96), has recommended that the Member States adopt a GAAR "adapted to domestic and cross-border situations confined to the Union and situations involving third countries".[32] Consequently, the OECD's proposal of inserting a GAAR in tax treaties should not come as a surprise.

As with every GAAR, that proposed in Action 6 implies a certain degree of indeterminacy. The concept of tax avoidance or abuse of tax law cannot be totally formalized or objectified, but the resulting uncertainty can be reduced to an acceptable level by procedural measures and by the courts. Therefore, such inevitable indeterminacy is not a conclusive argument against the adoption of a GAAR, as is demonstrated by the comparative panorama; however, it is possible that the PPT rule of Action 6 could be improved in this respect, as suggested by commentators. It should be remembered that states that negotiate tax treaties could adopt the wording of the clause that better suits their legal culture and satisfies their scruples.

Allegations of uncertainty frequently disguise a clear rejection of any GAAR. This attitude, which has its roots in certain legal-philosophical positions that can be labelled "formalistic", is unfailingly present whenever the enactment of a GAAR is proposed. Representatives of this position usually vehemently denounce the violation of the principle of legality and argue that tax avoidance is the result of deficient work on the part of the legislator and, therefore, it is the legislator's responsibility to counter loopholes in the system. This essential repudiation of GAARs, of course, serves the interests of those who avail themselves of aggressive tax planning, especially MNEs and their advisers. It is, therefore, no wonder that this position inspires many of the negative comments on the Public Discussion Draft on Action 6.[33] Such radical opposition to a GAAR also appears in the comments of Lang (2014), who goes so far as to affirm that the PPT rule "is not merely superfluous but also detrimental to legal culture", and emphatically concludes that "[t]he OECD should keep its hands out of it!"[34]

32. European Commission, *Commission recommendation on aggressive tax planning*, C(2012) 8806 final (6 Dec. 2012), para. 4.1. Also (2012/772/EU), OJEU L338/41 of 12 Dec. 2012.

33. OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* (OECD 2014), International Organizations' Documentation IBFD.

34. Lang, *supra* n. 13, at p. 663 et seq.