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Summary and conclusions

While it is difficult to identify precisely the commonality and differences of approach to tax treaties and tax avoidance, a number of conclusions can be drawn from the branch reports. First, it seems that in many countries the application of general anti-avoidance rules can be reconciled with tax treaty obligations. With significant exceptions, such as those reported in the Dutch and Portuguese reports, the statements in the commentary on article 1 OECD model convention (MC) in the changes made in 2003, in paragraph 22(1), that the domestic substance over form, economic substance and general anti-abuse rules are part of the basic domestic rules set by domestic laws for determining which facts give rise to a tax liability, seem to be endorsed in the branch reports for countries that have relevant experience. That conclusion is undisputed for sham and substance over form situations, but less certain where pursuant to the domestic anti-abuse doctrine the facts as they are determined have to be recharacterised in order to do justice to object and purpose of the applicable domestic law or tax treaty rule.

It is clearly more difficult to reconcile specific domestic anti-avoidance provisions with tax treaty obligations (except for treaty overrides). Where the results are mixed for CFC legislation, albeit that an increasing number of judgments conclude that these rules can be reconciled with tax treaties, discriminating thin capitalisation rules meet with the non-discrimination article and rules that seek to recharacterise income meet with autonomous treaty definitions. Countries generally have been able to preserve the application of their exit taxes, because the taxable event (the deemed disposition of assets) takes place just prior to the transfer of the residence to the other treaty country, but in a case where the balance of taxation rights would be altered in substance after the transfer of residence, the principle of good faith prevented the materialisation of the exit charge.

The issue of whether abuse of the tax treaty should be regarded as an abuse of domestic law or as an abuse of the tax treaty itself is addressed in a number of branch reports, but while the responses differ, in practice this does not seem to lead to different outcomes as a result of the different approaches. Notably, where tax avoidance would be the result of an interaction between the application of domestic law and of the tax treaty, the inquiry as to violation of the object and purpose of the rules was made both with respect to the domestic law and the treaty (in particular in the Antile case mentioned in the Canadian branch report). The threshold for abuse of the treaty is high in a number of countries, as is evidenced, inter alia, by case law in Canada and the Netherlands.

Nothing short of striking is the array of different outcomes in the treaty shopping cases described in section 2.5 of this report. While it must be recognised that the evidence, or lack thereof, of a tax avoidance motive and in general the appreciation of the facts play a significant role in tax litigation, very comparable facts have resulted in opposite judgments in treaty shopping cases. But even with appreciation for the factual elements, it is clear that the approach to interpretation in different countries is very different, varying from *pacta sunt servanda* in the Netherlands and India, to a denial of treaty benefits based on a lack of economic substance and the presence of a tax avoidance motive in Switzerland and Israel.

1. Introduction

In the past IFA has dealt with tax treaties and tax avoidance on several occasions, but to date no congress subject has been devoted specifically to this topic. In addition, no congress subjects or seminars have specifically addressed the changes made in 2003 to the commentary on article 1 OECD MC, dealing with improper use of the convention (the 2003 changes).

The first part of this report and of the branch reports addresses the application of domestic anti-avoidance rules and their relationship to tax treaties, i.e. the way the relevant rules (a) interact with and complement, (b) limit the application of, (c) are limited by, and, as the case may be, (d) are designed to circumvent limitations contained in, tax treaties. Although the reports do not deal in depth with general anti-avoidance rules or doctrines, to the extent that the application thereof is relevant to the application of tax treaties they have been addressed. Where the branch reports describe the relationship between tax treaties and domestic anti-abuse measures, they have often also addressed how the statements regarding the improper use of tax treaties in the 2003 changes can be reconciled with the rules and doctrines in the relevant country. The first part also covers whether abuse of the tax treaty itself is addressed under domestic law principles, or through interpretation of the treaty taking into account its object and purpose. The second part of the reports deals with tax treaty provisions that allow the application of domestic anti-avoidance provisions and with general and specific anti-avoidance provisions in tax treaties. This part gives an overview of such provisions incorporated in the tax treaties of the various countries and also addressed (a) the place of those provisions

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1. *Inter alia, at the seminar How Domestic Anti-avoidance Rules Affect Double Taxation Conventions at the IFA Congress of 1994 in Toronto (IFA Congress Seminar Series vol. 19c) and at the seminar Abusive Application of International Tax Agreements at the IFA Congress of 2000 in Munich (IFA Congress Seminar Series vol. 25b).*
in the tax treaty policy of these countries, (b) the relationship between general and specific anti-avoidance provisions, and (c) relevant case law.

Forty-four branches have submitted reports on the subject. Branch reporters in EU Member States have been asked to briefly discuss the relationship between domestic and/or tax treaty based anti-avoidance provisions and EU law. The branch reports are generally of high quality and give an unprecedented overview of anti-abuse doctrines and provisions with an international scope, their relationship to tax treaties, of the approaches to abuse of the tax treaty itself and of anti-abuse provisions in tax treaties. With 44 reports, and the mandatory space limit for this general report, it was an enormous challenge to do justice to the content of all reports and although your general reporter has made a genuine effort to address the main issues of the reports in this general report, inevitably choices had to be made and certain points have been omitted, may have been omitted inadvertently or may have been misconstrued. Fortunately, most branch reporters have followed the format of the directives, which enhanced a systematic approach by your general reporter. In the few cases where the branch reporters have chosen to ignore that format, reports are reflected in the general report to a lesser extent than could have been the case.

While this report is based on the content of the branch reports, the general reporter has occasionally taken the liberty to review and cite from income tax treaties and court cases that are relevant to the subject matter reported in the branch reports, even in cases where the branch report did not refer to or elaborate on the treaty or court case, as the case may be. On the other hand, references to the substantial body of academic work on the subject are omitted and this report aims to accurately depict the findings of the branch reports and identify how the relevant issues have been dealt in the reporting countries, without further elaboration. For mistakes in the coverage of the branch reports only your general reporter is responsible.

2. Domestic anti-avoidance provisions with international scope

2.1. Introduction

Many countries have had general anti-avoidance rules or doctrines for a long time or have adopted these recently. Specific anti-avoidance provisions have increased significantly in recent decades. Their features are varied and far-reaching; they impute income regardless of its realisation, reattribute income, recharacterise income,

2 Argentia, Australia, Austria, Belgium, Brazil, Canada, Chile, the People’s Republic of China, Chinese Taipei, Colombia, Denmark, Estonia, Finland, France, Germany, Hungary, India, Ireland, Israel, Italy, Japan, the Republic of Korea, Luxembourg, Mexico, Morocco, the Netherlands, New Zealand, Norway, Peru, Poland, Portugal, Romania, Russia, Serbia, Singapore, South Africa, Spain, Sweden, Switzerland, Ukraine, the United Kingdom, the United States of America, Uruguay, Venezuela.

3 In order to save space, citations of case law have been omitted throughout this general report, except where the case is not reported in the branch reports and except for EU cases mentioned in section 4.

disallow deductions, etc. With respect to general and specific anti-avoidance rules, the question can be raised whether and to what extent their application can be reconciled with tax treaty obligations. Does their application constitute a treaty override? Is their application in accordance with the good faith requirement of article 31 of the Vienna Convention on the Law of Treaties (VCLT)?

With respect to specific anti-avoidance provisions in domestic law, a distinction can be drawn between provisions that apply to all taxable persons and categories of income and have actually been devised to eliminate domestic tax avoidance and those that address cross-border situations. The first category has been covered in the branch reports to the extent that the operation of these measures is likely to affect or to be affected by treaties.

2.2. General anti-avoidance provisions with International focus or effect

Fully in line with the findings of Professor Zimmer, the branch reports establish that most countries have either statutory or court developed anti-avoidance rules. The nature and scope of these rules differ considerably from country to country. The doctrines can be summarised as sham, legally ineffective transactions, substance over form, abuse of law, fraus legis, or simply as the general anti-abuse rule (GAAR). The simplest of these doctrines and probably the only universal one is sham. In this approach, which is more a non-tax law concept than a tax law concept, the true nature and scope of these rules differ considerably from country to country. The doctrines can be summarised as sham, legally ineffective transactions, substance over form, abuse of law, fraus legis, or simply as the general anti-avoidance rule (GAAR). The simplest of these doctrines and probably the only universal one is sham. 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2.3. Specific anti-avoidance provisions with international focus or effect

The branch reports show a plethora of specific anti-avoidance provisions with international scope. These provisions address emigration of companies and individuals, redemption of pension entitlements, controlled foreign companies (CFCs) residing in low-tax jurisdictions, payments to companies that are non-resident or resident in low-tax jurisdictions, etc. For a number of these rules a great deal of commonality is present, e.g. exit taxes, CFC regimes and thin capitalisation rules. Other rules, however, are quite peculiar to only one or a few jurisdictions, e.g. the denial of exemptions to non-resident companies that are owned by residents of the source country (Israel). Apart from the less prevalent measures, four groups of provisions can be distinguished: provisions focused on situations (a) where a person ceases to be a resident of a country, (b) where income is moved offshore, (c) where the tax base of a country is eroded, and (d) where the character of income is changed.

2.3.1. Transfer of residence

The most prevalent provisions addressing the transfer of residence are those that entail fictitious (continued) residence upon the transfer of residence abroad (deeming provisions) and exit taxes. The fictitious residence provisions generally take the form of a fiction that a company incorporated under the law of a country continues to be tax resident in that country even where the effective management is relocated to another country, but sometimes, where the residence is based on incorporation, continued residence is based on effective management staying behind, as an anti-avoidance measure (Israel). Brazil has a fiction of continued residence for emigrated individuals (for 12 months following the emigration), but that rule seems an instrument to control emigration and distinguish a real change of residence from a simulated one rather than a substantive rule that purports to continue to tax the individual. Exit taxes have different appearances. In a number of countries a taxpayer is deemed to have disposed of all assets just prior to ceasing to be a resident. That rule may apply to individuals, individuals who conduct a business, and to corporate bodies. In certain cases the exit charge may relate to specific assets, such as a substantial interest in the share capital of a company (the Netherlands) or pension rights (e.g. Belgium, the Netherlands), or a combination of assets (Denmark). Some countries, such as Poland and Peru, do not have exit taxes. The United Kingdom does not have an exit charge for individuals but does impose a "re-entry" charge that denies the benefit of non-UK residence where the period of non-residence is temporary. This tax is levied on the disposal of certain assets and deems the gain to arise in the year that the individual becomes UK resident again.

2.3.2. Base companies

Clearly the most prevalent rules addressing the offshore income of base companies are embodied in CFC legislation. These rules have two basic formats. They either attribute income earned by a CFC to the shareholder of that entity (the "look-through" approach) or deem the shareholder to have received dividends from the entity (the "deemed dividend" approach). The CFC legislation may adopt a designated jurisdiction (low-tax countries) or global approach (tainted income). Other provisions addressing offshore income are so-called switchover clauses, in which the exemption for foreign dividend or branch income is substituted by a credit for foreign tax if the income is passive and/or lowly taxed or flat denial of an exemption without a credit in the case of lowly taxed foreign subsidiaries.

2.3.3. Base erosion

In this category thin capitalisation rules are clearly the most prevalent, although earnings stripping rules and rules limiting the deduction of interest payments to a percentage of assets seem to be occurring more frequently. Certain jurisdictions, e.g. Belgium, restrict the deductibility of expenses paid to non-residents if they are resident in countries with low or no taxation or in countries with a preferential tax regime. In Israel exemptions otherwise allowed to non-resident companies are not applicable if these companies are held for at least 25 per cent by residents of Israel.

2.3.4. Character of income

Depending on the particulars of the tax treatment of certain categories of income, the recharacterisation of income under domestic law may go in different directions. E.g. where a capital gain is taxed more heavily than a dividend (South Africa) recharacterisation rules operate to convert dividends into capital gains if the dividend is paid to avoid capital gains treatment. However, the contrary is true if capital gains treatment is more favourable than dividends treatment. A number of jurisdictions have rules that recharacterise capital gains derived from related party transactions to dividends if the economic interest in the shares that give rise to the capital gain remains, directly or indirectly, with the same person or group, but these rules may be used affirmatively by the taxpayer (United States). Thin capitalisation rules may recharacterise disallowed interest into dividend, but for withholding tax purposes dividend may be recharacterised as interest as well (Australia).

2.3.5. Miscellaneous

Apart from the above-mentioned domestic anti-avoidance provisions, there is a wide variety of less prevalent anti-abuse provisions mentioned in the branch reports. For instance, the Argentinian branch report mentions recharacterisation of the...
source of income for certain derivatives transactions, sourcing in Argentina of certain income of non-residents from certain international transactions (transport, shipping, reinsurance, film and video licences, television broadcasts and similar activities), etc. Countries that have natural or agricultural resources have rules that purport to prevent the use of interposed companies to prevent avoidance of the local tax (e.g. Australia). Quite interestingly, the Danish branch report mentions domestic rules that address hybrid entities and hybrid instruments, which may cause the Danish tax rules to follow the foreign characterisation of entities and/or instruments in order to prevent tax arbitrage. The branch report for the Netherlands mentions deemed employment income attributed to an employee who owns a so-called substantial interest in the employer entity. The US branch report mentions a variety of other rules, including those that limit deductibility of losses from the sale of property to foreign controlled affiliates and so-called “stapled stock” rules that result in the treatment of a non-US corporation as a US corporation if the stock of both entities is “stapled” and transferable as one unit only.

2.4. The relationship between the domestic anti-avoidance provisions and tax treaties

Whether and to what extent general and specific anti-avoidance measures with international scope can be reconciled with tax treaty obligations is not clear. For some countries, there is no doubt that the application of those rules cannot be reconciled with tax treaty obligations and in their view there is no need to provide clarity on this issue. In other states, however, the application of domestic anti-avoidance rules is often prevented by the provisions of an applicable tax treaty.

Are general or specific domestic anti-avoidance provisions consistent with the tax treaty practice and policy advocated by the OECD? And how sustainable are the statements made in the commentary on article 1 OECD MC in the light of the treaty interpretation principles that apply in various countries? After the 2003 changes, the commentary concludes that domestic law anti-abuse rules do not conflict with treaties (paragraph 22(1)), but it does not clearly distinguish between general and specific anti-abuse rules (paragraphs 9(1) and 22). In respect of substance over form, economic substance and general anti-abuse rules, the commentary states (paragraphs 22 and 22(1)) that these are part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability. According to the commentary, these rules are not addressed in tax treaties and are therefore as a general rule not affected by them; but is this indeed the case, i.e. also in cases where the operation of the anti-abuse rules does not result in a determination of the facts, but in a recharacterisation of these facts after they have been determined? The commentary further states that “it is important to note … that it should not be lightly assumed that a taxpayer is entering into the type of abusive transaction [described]” (paragraph 9(5)). Finally, it states that “there is agreement 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” (paragraph 22(2)). The branch reporters were asked to comment specifically on these remarks.

2.4.1. General domestic anti-abuse rules

The branch reports establish that in many countries the application of domestic general anti-abuse rules is consistent with tax treaty obligations. That is certainly the case for sham and substance over form doctrines. In Canada there was doubt whether the statutory GAAR applied to tax treaties, but this doubt was removed with retroactive effect by an amendment to the effect that the GAAR applies to “transactions that misuse or abuse a treaty” and, where necessary, overrides treaties. The situation is somewhat different in the case of certain anti-abuse doctrines, such as fraus legis. E.g. in the Netherlands the determination that a transaction was a sham and subsequent determination of the true nature of the transaction and also “independent determination” of the facts for tax purposes would certainly be followed for tax treaty purposes, but recharacterisation of transactions for domestic tax purposes pursuant to the fraus legis doctrine has so far not been respected for tax treaty purposes.

Germany has a long tradition of GAARs and article 42 of the General Fiscal Code is a potent provision that applies to domestic and international situations and because the effect of its application would be the determination of the proper facts, which can entail disregarding a foreign entity, its application is viewed as consistent with tax treaty obligations. Austria has article 22 of the Austrian Federal Tax Code, pursuant to which abuse of legal arrangements cannot serve to avoid tax. If an abuse is present, tax must be levied in accordance with a legal structure appropriate to the economic transactions. Although there is discussion whether this provision is merely an expression of an economic approach to taxation, or a provision that supplements substantive provisions (which would allow for a recharacterisation in the case of tax avoidance only and would thus be very similar to the Dutch fraus legis doctrine), that distinction seems irrelevant in the application of tax treaties, and the Austrian branch report mentions several inbound and outbound cases in which income was attributed to another person than would follow from the legal construct, regardless of the treaty.

The distinction made in paragraphs 9(2) and 9(3) of the commentary on article 1 OECD MC, between the approach in which the domestic anti-avoidance rules are viewed as part of the basic domestic rules set by domestic laws for determining the facts that give rise to a tax liability and the other approach where an abuse is regarded as an abuse of the treaty itself as opposed to an abuse of domestic law, is not a distinction that is generally reflected specifically as such in the branch reports, although some reports, e.g. New Zealand, do mention that their countries use the factual approach and, consequently, that the determination of the facts under domestic law is then followed for tax treaty purposes.

A striking example of a potentially different outcome depending on whether the factual (or perhaps in the United States the interpretive) approach is adopted and...
then followed for treaty purposes, or whether facts are recharacterised under a domestic abuse of law doctrine, is the treatment of a sale of shares as a dividend distribution. In the United States and New Zealand a transaction in which a shareholder sells shares in a company to a company controlled by this shareholder, with a view to realising the retained earnings as a capital gain rather than as a dividend, in order to obtain more favourable capital gains treatment, would be treated as a dividend using the factual approach (or perhaps in the United States the interpretive approach), but in the Netherlands that treatment used to be the result of recharacterisation with application of the fraus legis doctrine. In the approach followed by New Zealand and the United States, the dividend treatment also applies for tax treaty purposes. However, in the Netherlands the recharacterisation would be inconsistent with tax treaty obligations and for tax treaty purposes the sale would result in a capital gain, because the abuse would not be regarded as an abuse of the tax treaty. A capital gain derived by a resident of the United States in respect of shares in a company resident in the Netherlands could thus be regarded as a dividend (a) for US domestic law purposes, (b) for the Netherlands–USA tax treaty in the interpretation by the United States, and (c) for Dutch domestic law purposes (under prior law), but as a capital gain for the Netherlands–USA tax treaty in the interpretation by the Netherlands.

A number of branch reports indicate that the position in paragraph 22(1) of the commentary on article 1 OECD MC that domestic anti-abuse rules do not conflict with treaties is true for their country to the extent that GAARs are concerned. Some countries, such as Germany, differentiate and seem to take the position that the 2003 changes are not applicable to tax treaties concluded prior to 2003, although in practice this may not be an issue for Germany because of the inclusion, since 2000, of provisions in tax treaties that specifically allow the application of domestic anti-avoidance measures.

In some countries domestic GAARs may not be consistent with treaty obligations. For certain countries that is partially true, e.g. in the Netherlands where this is true only for the application of the domestic fraus legis doctrine, but in other countries the position seems to be that domestic general anti-avoidance rules are generally not compatible with tax treaties. Examples are Luxembourg and Portugal, which both made an observation with respect to the 2003 changes. The Portuguese report showed strong disagreement with the OECD position that domestic anti-abuse rules do not conflict with treaties. The branch report for India clearly states that in India tax treaties override domestic anti-abuse rules, although a recent case involving an international telecommunications company renders the situation unclear.

The Antle case in Canada is an interesting example of application of the Canadian GAAR in a cross-border situation. It is somewhat similar to the Kinsella case mentioned in the Irish branch report. The taxpayer in Antle tried to avoid Canadian tax on the alienation of shares by disposing of these shares tax free to a Barbados trust created for the benefit of his spouse. The trust then sold the property and claimed that the gain was not taxable pursuant to the Barbados–Canada tax treaty. The court found that the trust had not been legally created and the shares not transferred, but also ruled that even if that were different, the transactions could not be given their intended tax consequences pursuant to the GAAR. The court found that the object, spirit and purpose of the domestic provision were to tax the gain when the property would leave the marital unit and then considered that the spirit and purpose of the Barbados–Canada tax treaty did not conflict with the domestic provision. It is noted that in a somewhat similar Canadian case, Garron, it was decided, also as an obiter dictum, that no abuse of the treaty was present.

2.4.2. Specific domestic anti-abuse rules

2.4.2.1. Treaty override

With respect to specific domestic statutory anti-abuse rules a clear distinction must be drawn between countries that constitutionally can override tax treaties and those that cannot. Countries in the first category are, inter alia, Germany and the United States. Although these countries generally try to reconcile the application of specific domestic anti-avoidance rules with their treaty obligations, treaty override does occur. The German branch report mentions article 50d(3) of the German Income Tax Act, an anti-treaty (and directive) shopping provision that clearly is intended as a treaty override. In Australia treaty override is possible, but the intention to override must be clear and it seems that in general specific statutory rules are overridden by treaties.

2.4.2.2. Transfer of residence

Deeming provisions by virtue of which a person continues to be treated as a resident of a country upon the departure to another country are generally inconsistent with tax treaty obligations. Where the person becomes liable to tax in the arrival state based on the criteria mentioned in article 4(1) OECD MC, the tie-breaker of article 4(2) or 4(3) OECD MC, as the case may be, will generally cause the departure state to be the “loser” state and none of the branch reports suggests that the deemed residence will be upheld in such a case.

A prevalent form of exit taxation is the tax on capital gains in case of a change of residence. Although some branch reports, e.g. the Danish, Israeli and Swedish reports, note some tension between an exit tax on capital gains and tax treaty obligations, the position is generally that if the capital gains taxation takes the form of a deemed disposition of the relevant assets just prior to the discontinuation of residence, such tax is consistent with treaty obligations, in particular article 13(5) OECD MC, because the relevant person is not yet a resident of the other state at the

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13 See, however, the comment made in the Dutch report, at section 1.4.1.
14 E.g. Israel, New Zealand, Germany, Finland, Austria.
15 See section 2.5 below, where the Kinsella case is briefly described.
16 Canadian report, at section 1.4.2. See also section 2.5 below.
17 See e.g. the German report, at section 1.5.3.1 last paragraph, in respect of CFC rules and section 1.5.3.2 with respect to the unilateral switchover clause and the US report, at section 1.4.2. In the United States, if there is a clear conflict between the domestic law provision and the treaty, the “later in time” rule will cause the more recent provision to set aside the older provision.
18 German report, at section 1.3.1.
19 See, however, the Yanco-Weisse case in Israel, described in section 1.4.1, in which a company was deemed to have continued its residence in Israel following the transfer of its effective management to Belgium, also for tax treaty purposes.
time the taxable event (i.e. the deemed disposition) takes place. Some reports make the point that an exit tax is in fact not levied as an anti-abuse measure, but rather to maintain the coherence of the tax system. Where an exit tax with respect to capital gains was deemed consistent with tax treaty obligations, it was because (a) at the time of the taxable event the taxpayer was still a resident, and (b) the tax was not contrary to good faith required vis-à-vis the treaty partner because the balance of taxation rights was not altered. The situation can be different, however, if – in substance – the departure country levies its tax in respect of income that post emigration would be taxable in the country of residence, such as pensions and annuities. Accordingly, the Dutch Supreme Court held that an exit tax in respect of pension rights was inconsistent with article 18 of the Netherlands–Singapore income tax treaty, because that article allocates the taxation right with respect to pensions to the state of residence of the recipient of the pension and with the exit tax the balance of taxation rights would be altered and the levy would accordingly be contrary to the good faith required vis-à-vis the treaty partner.

Belgium employs a somewhat different rule pursuant to which the redemption of pension rights after emigration is deemed to have taken place on the day preceding the emigration. In the view of the Belgian legislator, this provision is justified in order to prevent abuse of article 18 OECD MC and the fact that, in the Belgian view, double non-taxation would otherwise result in such cases.

The UK re-entry charge is technically a charge in respect of a gain that arises in the year of residence (upon re-entry), but it may relate to a gain realised by a person who was a resident at the time of realisation, and may, according to the UK branch report, arguably be considered in breach of article 13(5) OECD MC. Interestingly, the UK branch report states that the UK tax authorities (HMRC) had previously accepted that a tax treaty with the state of temporary residence could prevent UK taxation of the realised gain upon re-entry, but apparently then changed their official view, stating that they had merely meant that the individual was able to claim a credit for foreign tax in respect of the gain in the other state. This position was subsequently legislated and could be seen as a treaty override if the treaty should operate to prevent the United Kingdom from taxing the gain.

If one looks at the UK re-entry charge against the background of the Dutch decision on the exit charge for pensions, and applies the test of whether the allocation of taxation rights is altered, the answer could be that this would indeed be the case in respect of gains realised after emigration from and prior to re-entry into, the United Kingdom, because these gains would normally be taxable in the country of residence only, pursuant to article 13(5) OECD MC.

2.4.2.3. Base companies

A significant number of countries address the use of base companies with CFC rules. The commentary to article 1 OECD MC (in paragraph 23) affirms that CFC legislation does not conflict with article 7(1) and article 10(5) MC. Case law

20 See e.g. Australia, Belgium, France, Germany, Luxembourg, the Netherlands.
21 See e.g. Austria, the Netherlands.
22 Dutch report, at section 1.4.2.1.1 and the German report, at section 1.5.3.5.
23 Dutch report, at section 1.4.2.1.1.
24 Belgian report, at section 1.3.9.

is divergent on the issue. A landmark case is Schneider, dealing with a French company that had a subsidiary in Switzerland subject to low taxation and engaged in managing financial assets. Pursuant to article 209B of the French tax code the income earned by the Swiss subsidiary was attributed to the French parent company. The court held that in the absence of a permanent establishment of the subsidiary in France, the business profits article in the France–Switzerland tax treaty prevented France from levying tax in respect of that income. Following the Schneider decision article 209B of the French tax code was amended and profits of a foreign low-taxed subsidiary are now no longer attributed directly to the French shareholder, but rather the foreign entity is deemed to have distributed a dividend, with the intended but so far untested consequence that deemed dividend distributions are either covered by the dividend article or by the other income article and can be taxed in France as state of residence of the shareholder.

In a subsequent Japanese case which was recently reviewed by the Japanese Supreme Court, it was argued that the Japanese CFC regime effectively imposed Japanese tax on the business profits of the relevant CFC, even though that CFC had no permanent establishment in Japan and, accordingly, this legislation violated the business profits article of the relevant tax treaty. The Japanese courts upheld the assessment and decided that the Japanese CFC legislation imposed the tax on the income of the Japanese shareholder and not on the income of the CFC and, therefore, that the legislation did not violate the business profits article of the tax treaty.

In Bricom Holdings, a UK tax case, the attribution of interest income to the UK shareholder of a company resident in the Netherlands was not prevented by the Netherlands–UK income tax treaty, but the decision is not dispositive of the issue, because the taxpayer apparently relied on the interest article of the tax treaty only and did not argue that the attribution of the interest income to the UK shareholder was contrary to the business profits article. According to the UK branch report the situation is still unclear and may depend on whether the income tax treaty is applied at the level of the non-resident CFC after which the income is attributed, or the other way around where the income is attributed to the UK shareholder under domestic tax law after which the income tax treaty is then applied with respect to that shareholder.

The UK report suggests that in this second approach the tax treaty would not protect the UK resident from a UK tax on the attributed income.

Interestingly, the Swedish report mentions that the Swedish legislator, in the context of Swedish CFC rules, has referred to paragraph 22(1) of the commentary on article 1 OECD MC and has indicated that the Swedish CFC rules are indeed part of the domestic rules for determining which facts give rise to a tax liability and, accordingly, the attribution of income under the Swedish CFC rules would be consistent with tax treaty obligations. It is suggested in the Swedish report that this is only true for treaties based on the OECD MC subsequent to 1992 and then only if the treaty partner has not made an observation or reservation with respect to the relevant part of the commentary. Also interestingly, the Swedish report men-

25 The latter approach was the approach taken in Schneider under the French subsidiary principle, in which income is attributed to a taxpayer under French domestic law followed by treaty application in respect of the taxpayer to whom the income is attributed, but the result was that France could not tax the income because in substance the profit was identical to the profit derived by a resident of Switzerland.
tions a Supreme Court case of 2008 in which the application of the Swedish CFC rules in the context of the 1963 Sweden–Switzerland tax treaty was at issue. The Swedish report notes that the Supreme Court considered that Sweden was not precluded from extending its taxation claims by way of a subsequent law in a way that was not in conformity with the treaty, suggesting that the court did not seek to reconcile the Swedish CFC rules with tax treaty obligations, but rather applied a treaty override. A decision of 2002 by the Finnish Supreme Administrative Court is nothing short of a direct endorsement of the commentary. A Finnish parent company owned a Belgian subsidiary that was engaged in group financing and that was subject to the Belgian coordination centre regime. The profit of the Belgian subsidiary was attributed to the Finnish parent company under the CFC rules and the court explicitly held that the business profits article and the non-discrimination article of the tax treaty between Belgium and Finland did not prevent Finland from taxing the income in the hands of the Finnish parent company. The court explicitly referred to the commentary where it stated that CFC legislation was “part of the basic domestic rules set by national tax law for determining which facts give rise to a tax liability and that these rules are not addressed in tax treaties and are therefore not affected by them”.26 Also the Danish report refers to a relevant case, adjudicated by the Danish National Tax Tribunal dealing with a Danish company that had a subsidiary in Switzerland that performed low taxed banking activities. Also in this case the court referred to the commentary and held that the Danish CFC regime was not contrary to Denmark’s tax treaty obligations, but stated that this was the case because the CFC rules only covered situations where income was taxed at a significantly lower rate than under Danish taxation, and the branch report questions whether the current Danish regime, which entails a comprehensive attribution of income regardless of the level of taxation, would still be consistent with tax treaty obligations.27

The only other country for which a court decision on the compatibility of CFC legislation and tax treaty obligations is reported is Brazil. The Brazilian report mentions a case in which the Brazilian CFC rules were considered overridden by articles 7 and 10 of the Brazil–Spain income tax treaty, but remarkably a second decision with respect to the same taxpayer for a different taxable period seems to have reached the opposite conclusion. The report concludes that domestic CFC law cannot be reconciled with tax treaty obligations, but the report is not entirely conclusive in this respect. Interestingly, the Brazilian branch report mentions that Brazil has, in a number of its tax treaties, included a specific provision that, according to the report, effectively prevents the application of CFC legislation.28

A number of reports, including that of Canada, mention that countries preserve the application of CFC legislation in their income tax treaties. In that case, of course, the application of the CFC regime can be perfectly reconciled with tax treaty obligations. In all other cases, the prevalent, but not undisputed position

26 Finnish report, at section 1.4.
27 Danish report, at section 1.4.2 on the relationship between domestic anti-avoidance provisions and tax treaties, CFC taxation.
28 E.g. art. 23(5) of the Brazil–Denmark tax treaty.
fixed ratio that would otherwise apply.\textsuperscript{38} In a few cases branch reports mention that a tax treaty explicitly preserves the domestic thin capitalisation rule with reference to article 9 OECD MC.

Two thorny issues with respect to the compatibility of domestic thin capitalisation rules and tax treaties are the recharacterisation of debt that exceeds the debt–equity ratio into equity, in which case interest that is denied deductibility is recharacterised as dividend, and the limitation of the application of these rules to debt from non-resident taxpayers.

The recharacterisation of interest into a dividend under domestic thin capitalisation rules and its compatibility with tax treaty obligations has rarely been tested. Of course, this recharacterisation is only put to the test if the tax treaty does not explicitly follow this recharacterisation. Two interesting cases are mentioned in the Russian report, the Swedwood–Tikhvin case and the Ferrotex case, dealing with excess interest paid to a resident of the Netherlands and to a resident of Germany respectively. The Russian courts held that the income tax treaties had to be interpreted autonomously and that the excess interest had to be treated as interest under the applicable tax treaties.\textsuperscript{42}

The reports that deal with the compatibility of discriminatory thin capitalisation rules seem to justify the conclusion that where the thin capitalisation rule applies only to non-resident lenders (and would not be consistent with the arm’s length principle), the application of that rule would be prevented by article 24(4) OECD MC.\textsuperscript{40} The French Andritz case suggests that article 24(5) OECD MC may prevent application of thin capitalisation rules that restrict deductibility of payments to non-resident parent companies, even where the payments would not be at arm’s length.\textsuperscript{41}

2.4.2.5. Character of income

As stated in section 2.3.4, domestic law may recharacterise income with a view to undoing the more favourable tax treatment that the taxpayer was looking for when it structured a transaction so as to change the character of the income from a less favourable to a more favourable type. The UK branch report mentions the case of structuring – by taxpayers – a return on a financing transaction as a different form of income or as a capital gain and reports that the UK tax code has numerous anti-avoidance and other provisions that would treat the income resulting from the structuring as interest. The report makes the remark that the OECD MC has an exhaustive definition of the term interest and states that the OECD MC does not appear to be “synchronised” with the recharacterisation under domestic law. Following from this, the UK branch report makes the point that there is doubt whether the statements of paragraph 22(1) of the commentary on article 1 OECD MC are valid for the United Kingdom. The report suggests that where a tax treaty contains

\textsuperscript{38} Korean report, at section 1.3.
\textsuperscript{39} Russian report, at section 1.4.3.
\textsuperscript{40} See, inter alia, the German report, at section 1.5.3.3, where it mentions a recent case by the Fiscal Court of Cologne dealing with the previous thin capitalisation provisions and the non-discrimination clause in the income tax treaty between Germany and Switzerland, the Mexican report, summary and conclusions and the Russian report, at section 1.4.3.
\textsuperscript{41} French report, at section 1.4.

\textsuperscript{42} Ibid., at section 1.4.3.3.
\textsuperscript{43} Dutch report, at section 1.4.2.1.3.
2.5. Abuse of the tax treaty itself: domestic law principles or interpretation of the treaty?

In a slight deviation from the approach of paragraphs 9(2) and 9(3) of the commentary on article 1 OECD MC, the branch reporters were asked to comment on their country’s approach to abuse of the tax treaty itself; would such abuse be addressed under domestic law principles, or by interpretation of the tax treaty? Interestingly, the responses differ considerably. In some countries there is no precedent at all and the branch reporters were not able to give guidance.44 The Belgian branch report expresses doubt about whether, in the absence of a domestic general anti-avoidance doctrine, an anti-abuse principle can be recognised for tax treaty purposes. Certain reports clearly expressed that abuse of the treaty must be addressed through interpretation of the treaty itself, and in a number of instances reference is made to article 31 VCLT.45 A significant number of reports indicate that abuse of tax treaties is dealt with by applying domestic anti-abuse principles.46 Interestingly, the Swiss report puts Switzerland in this category, although the A Holding case discussed below could easily be seen as evidence to the contrary. Then there are countries in which no clear line is drawn and where abuse of the treaty itself can be addressed either through domestic law principles or by interpretation of the treaty.47

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. In recent years a number of treaty shopping cases have gone through the courts in the reporting countries and the outcome of these cases and the reasoning of the courts provide for an array of diverging positions. Clearly, certain blatant forms of treaty shopping are addressed through the inclusion of the beneficial ownership condition in tax treaties and by the interpretation of this term. Beneficial ownership cases are addressed in the second part of this report. In each of the cases to be addressed below the tax authorities sought to deny the benefits of a tax treaty that existed either in application of the dividends, interest, royalties, or capital gains article.

A well-known case, reported in the Canadian branch report, is MIL. MIL Investments (MIL) was a company resident in the Cayman Islands and it owned shares in Diamond Field Resources Ltd (DFR), a company resident in Canada. MIL entered into several transactions. In a tax free transaction it exchanged a number of DFR shares for other shares. Subsequently, MIL reincorporated in Luxembourg and became a resident of Luxembourg for Luxembourg tax purposes. MIL then sold some of the shares it had received in exchange for the DFR shares and later it disposed of its entire interest in DFR, realising a significant capital gain. That capital gain was taxable under Canadian domestic tax law, but if MIL could successfully invoke the protection of article 13 of the Canada–Luxembourg income tax treaty, the gain would be exempt from taxation in Canada. The Canadian tax authorities argued that MIL could not rely on the Canada–Luxembourg tax treaty, invoking the Canadian GAAR. Although the Canadian court was receptive to the GAAR argument, it found that one of the conditions for the application of the GAAR, an avoidance transaction, was not present. The court found that the sale of the DFR shares was not an avoidance transaction and even if the other transactions would have been avoidance transactions, the absence of an avoidance motive with respect to the sale of the DFR shares prevented application of the GAAR and, accordingly, MIL prevailed. The court tested the transaction against the Canadian GAAR, a domestic anti-avoidance rule that by operation of domestic law was deemed to apply to tax treaties (with retroactive effect), but then went on to test whether there was an anti-abuse rule inherent in the treaty that was violated, which it found not to be the case. The court in fact rejected the notion that there was an anti-abuse rule inherent in the treaty and referred in this respect to paragraph 7 of the commentary to Article 1 OECD MC of 1977.48 Interestingly, the court noted that using one foreign country over another as an avenue of investment into Canada was not improper as such.

In the recent Garron case, shares in a Canadian company were, after a reorganisation, owned by a trust arguably resident in Barbados. The shares were sold by the trust and an exemption from Canadian tax was claimed based on the capital gains article in the Barbados–Canada tax treaty. The court found that management and control of the trust were in Canada and concluded that it was a resident of Canada for purposes of the treaty. In an interesting obiter dictum, the court considered whether (a) a Canadian deemed residence rule, (b) a Canadian attribution rule, and/or (c) the GAAR would have resulted in taxation of the gain in Canada, should management and control of the trust have been in Barbados. Based on the plain meaning of the treaty text and the fact that for another Canadian attribution rule the treaty contained a proviso, the attribution rule was deemed inconsistent with the treaty. Moreover, the court determined that even if the facts justified the conclusion of deemed residence in Canada, either based on the applicable rule of domestic law or based on GAAR, that would not result in an abuse of the treaty, and the court referred to the plain language of the treaty and the absence of any indication that the contracting states had wished to preserve Canada’s right to tax the gain. As in the Antle case, the court tested the transactions under GAAR and against the treaty and found that the plain wording of the treaty would have overridden the application of the domestic rule, a result that given the similarity of the issues could be seen as somewhat at odds with Antle.

A Dutch case, briefly referred to in the Dutch branch report, dealt with the transfer of the effective management of a Dutch company to Belgium, almost immediately followed by dissolution of the company. The Dutch Supreme Court did not honour the arguments by the Dutch tax authorities that by granting treaty benefits in respect of the liquidation distribution an abuse of the treaty would be present. The Supreme Court quite rigidly held that neither the treaty text nor the explanatory

44 E.g. Colombia, Serbia, Sweden, Ukraine.
45 Reports that suggested or indicated that abuse must be addressed through interpretation of the treaty itself include Finland, India, New Zealand, Norway, Venezuela.
46 E.g. China, Estonia, France (very explicitly), Ireland, Korea, Luxembourg, Poland, South Africa (very explicitly). The French report mentions in section 1.5 that “‘[the] abuse of a tax treaty is legally granted in the statutory general anti-avoidance abus de droit. Abuse of tax treaties may be sanctioned only based on the statute and not on the [income tax treaty] itself. … Unless an abus de droit is characterized under domestic law, there can be no situation of abuse of a tax treaty.’”
47 E.g. Austria, Canada, Chinese Taipei, Germany, Israel, Japan, Russia, the United States.
48 Certain treaty shopping cases mentioned in the branch reports are omitted from the coverage.
notes to the treaty supported the view that the purpose and intent of the treaty would be ignored if the income were not taxed in the Netherlands.

Another case in which the tax residence of a company was transferred to a treaty jurisdiction is the Yanko-Weiss Holdings case in Israel. Yanko-Weiss Holdings was a company that was tax resident in Israel. It owned shares in a subsidiary that was also resident in Israel. In 1999 Yanko-Weiss Holdings moved its effective management to Belgium and became a resident of Belgium under Belgian tax law. In the following year it received a dividend from its Israeli subsidiary and claimed the reduced dividend withholding pursuant to the Belgium–Israel income tax treaty. The Israeli tax authorities refused Yanko-Weiss Holdings the benefit of the tax treaty, arguing that there was no economic purpose for its residence in Belgium and that the emigration to Belgium should be regarded as a sham. According to the Israeli branch report, the Israeli tax authorities explicitly took the view that domestic anti-avoidance rules were consistent with Israel’s income tax treaties and that relief under a double tax treaty could be denied through the application of the domestic anti-avoidance provisions. The Israeli court, in a preliminary procedure, confirmed that treaty benefits could indeed be denied in the presence of a sham transaction. According to the Israeli branch report, the Israeli court referred to paragraphs 9(2) and 9(3) of the commentary to article 1 OECD MC, but according to the report the court seems to have based its decision on a good faith interpretation of the treaty itself, rather than on the application of domestic anti-avoidance rules to determine the proper facts. While the Yanko-Weiss Holdings case is only a preliminary proceeding, in which it was determined whether the Israeli tax authorities could invoke the sham argument, either based on “proper determination of the facts” or on abuse of the treaty, and – according to the branch report – it still has to be determined whether the emigration of Yanko-Weiss Holdings to Belgium indeed was a sham or abusive, as the case may be, the decision is of importance because it explicitly opens the door to denial of treaty benefits in the context of abuse. In this respect the Israeli court seems to be much less strict than the Dutch Supreme Court in the case referred to above, and than the Canadian court in MIL, although in the latter case the factual determination that the sale of the DFR shares was not tax motivated may have been a factual determination that stood in the way of denial of treaty benefits.

In a reported Irish case, Kinsella, somewhat comparable to the Antle case mentioned in section 2.4.1, a resident of Ireland had sold shares to his spouse, just after she had transferred her residence to Italy, in a tax free transaction. Within a month from the purchase of the shares, the spouse sold the shares to a third party, realising a relatively small gain for Italian tax purposes, which was reported in Italy. Apparently, the taxpayer sought review of the Irish tax position under the Ireland–Italy income tax treaty and confirmation that the gain was not taxable in Ireland, with the Irish High Court, which referred to the VCLT and held in favour of the taxpayer, i.e. that the treaty applied to Irish capital gains tax and that the former resident of Ireland had become a resident of Italy for the purpose of the income tax treaty, and, accordingly, that the gain was indeed not taxable in Ireland. Interestingly, the Irish branch report notes that the judge “reminded the Irish Revenue Commissioners of [their] ability to invoke [domestic anti-avoidance measures] and the judge apparently referred to the case as arising “from tax avoidance measures”.

The Irish report suggests that these domestic law anti-abuse measures can be invoked to address abuse of the tax treaty.

MIL, the Dutch case and Yanko-Weiss Holdings have in common that prior to an anticipated benefit (capital gain, liquidation distribution, dividend) the tax residence of a company was moved to a favourable tax treaty jurisdiction. In Kinsella the residence of an individual was moved in order to escape capital gains tax and income tax in one of the treaty states. To varying degrees these cases bear symptoms of “last minute tax planning” and as a result one would think that they might be more prone to an anti-abuse approach than the cases in which the favourable tax treaty jurisdiction was used from the outset. However, as can be derived from the described cases, the outcome is very much dependent on the appreciation of the facts by the court and the strictness of the legal doctrine when it comes to application of an anti-avoidance doctrine. But also in situations where the structure was set up from the beginning with a view to obtaining treaty benefits that would not have been available directly, the results have been mixed in different countries. In a landmark case in Switzerland, a Holding ApS,51 handed down in 2005, a company resident in Guernsey had interposed a Danish holding company, a Holding, in order to own the shares in a company resident in Switzerland. A Holding was a mere holding company, without any economic activity in Denmark, which clearly had been organised only with a view to obtaining the benefits of the Denmark–Switzerland income tax treaty. A Holding received a dividend from its Swiss subsidiary and invoked the benefits of article 10 of the tax treaty. The Swiss tax authorities denied the benefit of the treaty, arguing that A Holding had only been organised with a view to obtaining treaty benefits and that granting these benefits would be tantamount to an abuse of the treaty. The reasoning of the Swiss court and also the comments thereon in the Swiss branch report are extremely interesting in the context of the subject at issue. The Denmark–Switzerland tax treaty does not contain a general or specific anti-abuse provision that would result in denial of the treaty benefits. The court, however, referred to the principle of good faith that should be observed in the interpretation of treaties and held that the principle of good faith entailed the prohibition of abuse. The court also referred to the recognition of the principle of abuse of rights in Denmark, that Denmark had not made a reservation against the Swiss anti-abuse decree of 1962 and furthermore, although the treaty at issue was concluded in 1973, referred to the 2003 changes, in particular paragraph 9(4), and then denied A Holding the benefits of the treaty. Interestingly, although the arguments recited by the Swiss court seem to indicate that the abuse of the tax treaty was primarily approached by interpreting the treaty itself, the Swiss branch report submits that the abuse of a tax treaty must be regarded as an abuse of domestic law, as a result of the monism of the Swiss legal system. Accordingly, the branch reporter puts Switzerland in the category of countries mentioned in paragraph 9(2) of the commentary to article 1 OECD MC (countries that regard abuse of the treaty as an abuse of domestic law).

It seems that India, in the reported Azadi Bachao Andolan case, arrives at the exact opposite of the Swiss position. The matter concerns so-called public interest
litigation in which the effect of a circular that denied companies resident in Mauritius the benefit of the India–Mauritius tax treaty if these residents were engaged in treaty shopping was put to the test. The circular was quashed by the Supreme Court of India and the court explicitly held that the motives for incorporation of a company in Mauritius were irrelevant in determining the availability of treaty benefits and, moreover, that if it was intended that a national [sic] of a third state should be precluded from the benefits of the India–Mauritius income tax treaty, then an explicit LOB provision should have been incorporated in the tax treaty. This decision is very much in line with a Dutch case of 1994, in which the Dutch Supreme Court decided that interposition of a company with a view to obtaining a reduction of dividend tax was not contrary to the object and purpose of the Dutch dividend tax act and the tax arrangement for the Dutch Kingdom.\footnote{HR, 18 May 1994, BNB 1994/253.}

However, the Indian branch report also mentions a more recent case in which an international telecommunications group owned a 67 per cent interest in an Indian joint venture company, indirectly through companies resident in Mauritius and the Cayman Islands. When the group disposed of its interest indirectly, by disposal of the entire shareholding in a company resident in the Cayman Islands, which was the indirect owner of the interest in the joint venture, the Indian tax authorities argued that notwithstanding the fact that no shares in the Indian joint venture company had been transferred a taxable sale of Indian assets had taken place. The Indian branch report cites from the court decision that

“\[p\]rima facie, the main company of the seller group, by reason of this transaction, has earned income liable for capital gains tax in India as the income was earned towards sole consideration of transfer of its business/economic interests as a group in favour of the main company of the buyer group. The subject matter of the present transaction between the buyer and seller is nothing but transfer of interests, tangible and intangible, in Indian companies of the seller group in favour of the buyer and not an innocuous acquisition of shares of some Cayman Islands company ...”

The approach by the tax authorities and the court seems to be to simply ignore the interposition of the intermediate companies, an approach that could be at odds with the Supreme Court case in which the circular of the Indian tax authorities was quashed. However, the telecommunications case is still in court and the facts and reasoning are somewhat unclear, and, accordingly, it seems premature to see it as a reversal of the position taken in the Azadi Bachao Andolan case.

A comparable case, although with a somewhat different treaty position, is reported in the Chinese branch report. In the Chongqing Yuzhong case, a company resident in Singapore owned a 31.6 per cent interest in a company resident in China, through its wholly owned Singapore subsidiary. The intermediate company had no other assets. The ultimate parent company transferred its shares in the Singapore intermediate company to a Chinese buyer. If the form of that transaction had been followed, no taxable gain would have arisen, because the sale of shares in a company that is resident in Singapore is not a taxable event in China. However, if the Singapore intermediate company had sold the 31.6 per cent interest in the

\footnote{Ibid.\footnote{From the information on Barbados in the IBFD database (Caribbean – Taxation & Investment), one could draw that conclusion under current law.}}
A few interesting cases are reported in the Korean branch report.6 The report mentions that it is difficult to ascertain whether tax treaty abuse is addressed under domestic law principles or through treaty interpretation, but the branch reporter is inclined to reach the first conclusion, i.e. there seems to be a tendency to rely on domestic law. The report mentions a 1993 treaty shopping case, in which the Korean Supreme Court denied the benefits of the Korea–Netherlands tax treaty to a company resident in the Netherhlands, in respect of a capital gain, because “the head office of the Dutch company, while registered in the Netherlands, was merely a shell company without economic substance and, thus, failed to qualify as Dutch resident eligible for the treaty benefits concerned”. This conclusion is similar to the conclusion in Yanko-Weiss Holdings and the Chinese Xinjiang case. The Korean branch report also mentions three cases recently decided by the Seoul Administrative Court, all dealing with the same fact pattern, in which a private equity fund owned shares in a Korean immovable property holding company through a chain of companies in Bermuda, Luxembourg and Belgium. The Korean tax authorities denied the benefits of the Belgium–Korea tax treaty on the grounds that the Belgian company had no substance in Belgium. The branch report notes that the Seoul Administrative Court supported the arguments of the tax authorities that the domestic substance over form rule should be respected in determining which tax treaty should be applied.

It is difficult to find a distinct pattern in the cases reported in the branch reports. It is clear that in certain countries the domestic anti-avoidance rule is the principal starting point in the tax treaty analysis, e.g., in Canada in Antle and MIL, and perhaps in Korea. The Yanko-Weiss Holdings and A Holding cases may from a technical legal nature have been decided with recourse to domestic anti-abuse rules; the reasoning in both cases seems to indicate that an inquiry is made into the object and purpose of the tax treaty and in fact that a tax treaty is subject to a general anti-abuse proviso, in the context of the good faith interpretation prescribed by article 31 VCLT. From both cases it is clear that the 2003 changes have significant influence on the attitude of the courts. On the other hand, the principle of pacta sunt servanda seems to stand without vulnerability to an anti-abuse proviso in the Netherlands and India and, judged by MIL and Garron, also in Canada. Particularly in India the position seems to be that a country that wishes to limit treaty shopping should do so by the inclusion of LOB clauses in its treaties rather than trying to achieve that result in court, although the recent telecommunications case may have unsettled that position.

Separate mention is deserved of the Bank of Scotland case described in the French branch report. Bank of Scotland acquired from a US parent company a three-year usufruct in respect of shares in the French subsidiary of the US parent company. Upon receipt of dividends, the Bank of Scotland invoked the benefits of the France–UK tax treaty in order to reduce the French dividend withholding tax and to receive the payment of the French avoir fiscal. The French tax authorities argued that in fact the Bank of Scotland had lent monies to the US parent company and the latter in substance had directed the dividends from its French subsidiary to be paid directly to the Bank of Scotland in satisfaction of obligations under the loan. Before the French court could conclude that the Bank of Scotland was not the beneficial owner of the dividend, the court had to apply the French abuse of law doctrine to attribute the dividends to the US parent company. In doing so, it applied the domestic abuse of law doctrine. The French branch report states in this respect that “the French view of the abuse of the [income tax treaty] based on the subsidiarity principle appears consistent with §9.2 of the OECD commentaries, under article 1 which refer to domestic provisions as the main and necessary source … and not with §9.3 which covers jurisdictions with distinct abuses of [tax treaties]”. The US branch report describes a number of conduit cases dealing either with interest or with royalties. These cases suggest that even within one country it is not always clear whether the treaty is interpreted or domestic substance over form principles are applied, although the US branch report submits that the application of domestic law principles is the norm. As the following cases show, quite similar fact patterns may result in different outcomes. A landmark case is Aiken Industries, in which a Bahamian lender to its US subsidiary had assigned a note to an interposed Honduran company, with a view to benefiting from the interest article in the Honduras–USA tax treaty. The Honduran assignee had issued its own note to the Bahamian company and all interest received by it was immediately paid on to the Bahamian company. In order to benefit from the exemption in the United States, the interest had to be “received by” a resident, corporation or other entity of Honduras (and the treaty did not contain the beneficial ownership requirement). The Tax Court seemed to interpret the treaty rather than to apply a sham analysis, when it considered that:

“[a]s utilized in the context of article IX, we interpret the terms ‘received by’ to mean interest received by a corporation of either of the contracting States as its own and not with the obligation to transmit it to another. The words ‘received by’ refer not merely to the obtaining of physical possession on a temporary basis of funds representing interest payments from a corporation of a contract State, but contemplate dominion and control over the funds.”

The court concluded that the Honduran company was “merely a conduit” and a “collection agent” and thus the interest payment did not qualify under the treaty.

In the Teong-Chan Gaw case, the Tax Court arrived at the same conclusion, but applied substance over form principles and referred to a lack of business purpose and in Del Commercial Properties, the District of Columbia Court denied treaty benefits seemingly based on the step transaction doctrine, but probably in reality based on a substance over form approach. Yet in a comparable case, Northern Indiana Public Service Company, where a Netherlands Antilles subsidiary of a US parent company was used as a conduit to borrow in the Eurobond market, the court arrived at the opposite conclusion, distinguishing the case from Aiken by virtue of the fact that the interposed company earned an interest spread and had borrowed from unrelated parties. A similar result came out of SDM Netherlands BV, dealing with a royalty conduit.

6 Korean report, at section 1.4.
3. General and specific anti-avoidance provisions in tax treaties

3.1. General overview

This part of the report deals with general and specific anti-avoidance provisions in tax treaties. An overview is given in general of such provisions contained in the tax treaties of the reporting branch countries and, where possible, (a) the place of those provisions in the tax treaty policy of the relevant country, (b) the relationship between general and specific anti-avoidance provisions, and (c) relevant case law, is described.

3.2. Specific treaty provisions allowing application of domestic anti-avoidance provisions

Consistent with the finding that in many countries domestic general anti-abuse rules are generally in line with tax treaty obligations, relatively few tax treaties contain a provision that allows the application of general domestic anti-abuse rules. The countries that report occasional inclusion of these treaty provisions are Austria, Belgium, Canada, China, Denmark, Italy, Korea, Luxembourg, the Netherlands, Portugal, Russia, Singapore, Sweden, Switzerland and Ukraine. The Finnish, Indian, Norwegian and Serbian reports indicate that the treaties concluded by these countries do not have provisions that allow the application of a domestic general anti-avoidance rule. The current tax treaty policy of Germany and Israel seems to be to always include a provision that allows the application of domestic anti-abuse rules, even though in both countries the doctrine is that domestic general anti-avoidance rules can be applied in interpreting tax treaties, and the incorporation of the treaty provision allowing the application of the domestic general anti-avoidance rule must be seen as an amplification of that position. In contrast, the Canadian report mentions that the incorporation of an explicit preservation of domestic anti-avoidance rules in a few treaties has resulted in negative inference in a case where such a provision was not included in the treaty.57 The Chinese, Estonian, French and New Zealand reports indicate that from the perspective of these countries it is not necessary to include provisions in their tax treaties allowing the application of domestic general anti-avoidance rules, because of the domestic position that the application is possible and can be reconciled with tax treaty obligations and in the case of China and New Zealand explicit reference is made to the 2003 changes. Interestingly, the Polish branch report mentions that the inclusion of a provision allowing the application of domestic general anti-avoidance rules is superfluous, because of the fact that the Polish Constitution practically precludes application of general anti-avoidance measures. Consistent with the above findings, most countries that do not have a tax treaty policy of including a provision allowing the application of domestic anti-avoidance rules do not object to having these provisions in their tax treaties with Germany and Israel.

57 Canadian report, at section 1.4.2.

58 Of course, art. 9 OECD MC is addressed in the context of thin capitalisation provisions.
purposes; for the purposes of this provision, any income from a source in a country other than Canada which pertains to or is incident to an active business carried on in a country other than Canada shall be deemed to be income from an active business.”

Less prevalent, but still present in the tax treaty policy of, inter alia, Canada, the Netherlands and the United Kingdom are provisions preserving the taxation rights in respect of certain income and/or capital gains derived by former residents of these countries. For example, article XIII(5) of the Canada–Israel income tax treaty provides as follows:

“The provisions of paragraph 4 shall not affect the right of either of the Contracting States to levy, according to its domestic law, a tax on gains from the alienation of any property derived by an individual who is a resident of the other Contracting State and has been a resident of the first-mentioned State at any time during the five years immediately preceding the alienation of the property.”

Certain treaties make a distinction between capital gains that accrued before and those that accrued after emigration, in that the departure country may tax the pre-emigration gain and the arrival country the post-emigration gain.59

Treaty provisions that purport to preserve a redetermination of the character of income under domestic rules can be found both in the context of thin capitalisation rules that recharacterise interest into dividend, but also in the context of domestic rules that purport to treat as dividend interest that is paid in respect of hybrid instruments, such as contingent interest notes. An example is article 10 of the income tax treaty between Australia and Russia:

“The term ‘dividends’ as used in this article means income from shares, as well as other amounts which are subjected to the same taxation treatment as income from shares by the law of the State of which the company making the distribution is a resident for the purposes of its tax.”

In some treaties the definition of interest in article 11 is then clarified to the effect that interest does not include income dealt with in article 10 (dividends).60

Certain other provisions preserving the application of specific domestic anti-avoidance provisions are left without mention here, except that it is noted that the Moroccan branch report mentions the preservation of the force of attraction rules in certain of its tax treaties.

3.3. General anti-avoidance provisions in tax treaties

The scope of the term “general anti-abuse provision” has been interpreted differently by different branch reporters and some have included under this heading a description of tax treaty provisions that are sometimes referred to as general, but

59 See e.g. the Danish report, at section 1.4.
60 See e.g. art. 12 of the 1992 Netherlands–USA income tax treaty.

other times as specific, such as LOB provisions. For the purpose of this general report the scope of the term “general anti-avoidance provision” is limited to those tax treaty provisions that one way or another comprehensively deny treaty benefits in the case of improper use of the tax treaty. Other anti-avoidance provisions, even if they have been dealt with by some branch reporters under the heading “general anti-avoidance provisions in tax treaties”, including so-called LOB provisions, will be addressed in the next section, which deals with specific anti-avoidance provisions in tax treaties.

As is also observed in the report of the UN Subcommittee on Improper Use of Tax Treaties, the inclusion of a general anti-abuse rule in a tax treaty can have the disadvantage that inclusion could be construed as a recognition of the fact that without such inclusion treaty abuse cannot be addressed and that would then be problematic in the interpretation of tax treaties without the inclusion of the general anti-abuse proviso. This observation resonates in the Canadian branch report. Perhaps against this background and probably also because of the fact that in many of the reporting countries the application of domestic general anti-abuse rules is generally regarded as consistent with tax treaty obligations, the inclusion of general anti-avoidance provisions in tax treaties is the exception rather than the rule. Certain branch reports, e.g. Argentina, state that none of the tax treaties concluded contains a general anti-abuse provision. None of the branch reports indicates that the inclusion of general anti-avoidance provisions in a tax treaty has consistently been part of the tax treaty policy of the relevant country, although the Belgian branch report mentions that the Belgian draft model convention of 2007 contains a general anti-abuse provision that would deny the benefits of the treaty where “the main purposes or one of the main purposes of [a] resident or a person connected with such resident was to obtain the benefits of the convention”,61 and the Portuguese report mentions that Portugal “has recently adopted a policy of introducing some general provisions into its treaties, aimed at counteracting an application of the treaty provisions that might be said to be an abuse of the general principles of the treaty”. The Chinese branch report mentions a number of tax treaties concluded by China since 2006 that contain “general articles”, but according to the report the only general anti-avoidance provision in a tax treaty is article 21 of the China–Czech Republic income tax treaty (not yet in force as of the conclusion of the Chinese branch report), which reads as follows:

“1. Notwithstanding the provisions of any other articles of this Agreement, benefits provided under this Agreement shall not be granted to companies of either Contracting State if the purpose of such companies is to obtain benefits under this Agreement that would not otherwise be available.

2. The provisions of this Agreement shall in no case prevent a Contracting State from the application of the provisions of its domestic laws aiming at

62 Canadian report, at section 1.4.2.
63 However, apparently this clause is not pursued, because the report also states that Belgium does not include in its income tax treaties explicit general anti-abuse provisions.
treaty country to another, with the goal of preventing the taxation of the redemption of pension rights or the accrued capital gain in respect of shares owned by the emigrating person.

With respect to the pension rights the issue is not that payments under a pension plan are taxable in the state of residence. That is fully consistent with article 18 OECD MC. Abuse may be perceived where a person ceases to be a resident of the state in which the contributions to the pension plan gave rise to a deduction and then, after emigration, receives a lump-sum payment in lieu of regular pension payments. As is suggested in paragraph 5 of the commentary on article 18 OECD MC and in certain countries confirmed in case law, a lump-sum payment would be covered by article 18 OECD MC and therefore be taxable only in the state of residence. The perceived abuse arises particularly where the new residence state does not tax the lump-sum payment and subsequent to the redemption the recipient of the lump sum returns as resident to the country of former residence. Remarkably, very few branch reports mention the redemption of pensions as described as a type of abuse that is addressed with domestic and/or treaty provisions, but the countries where this is reportedly an issue have included specific anti-avoidance provisions in a number of their tax treaties. E.g. in the Netherlands, where the courts have ruled that a lump-sum payment in lieu of regular payments is indeed covered by article 18 OECD MC and where subsequent legislation that introduced an exit charge upon emigration was deemed contrary to good faith, it is now established tax treaty policy to include a specific treaty provision that preserves Dutch taxation rights in respect of lump-sum payments upon redemption of pension rights. A good example is article 18 of the income tax treaty between the Netherlands and Sweden:

“Article 18
Pensions, annuities and social security payments
1. Subject to the provisions of paragraph 2 of article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment and any annuity shall be taxable only in that State.
2. However, where such remuneration is not of a periodical nature and it is paid in consideration of past employment exercised in the other Contracting State, or where instead of the right to annuities a lump-sum is paid, this remuneration or this lump sum may be taxed in the Contracting State in which it arises.
3. …”

The Swiss branch report mentions a comparable provision that was included in the 1977 UK–Switzerland tax treaty in a protocol of 2007.

The transfer of residence to a treaty country with a view to escaping accrued capital gains was addressed earlier in this report in section 2.2, where a tax treaty provision was mentioned that preserves the right to tax gains from the alienation of certain property by a resident of a tax treaty state for the departure state.

3.4.2. Treaty shopping

It is clear from the 2003 changes, the report of the UN Subcommittee on Improper Use of Treaties and from the treaty shopping cases reported in section 2.5 of this
general report, that treaty shopping is widely perceived as a problem. This is also evidenced by the inclusion of the term “beneficial owner” in articles 10, 11 and 12 of the OECD MC in 1977. It is also clear that addressing treaty shopping with doctrines such as sham, substance over form, or abuse of law, whether or not embedded in domestic law or in the tax treaty, is an uncertain path to success for tax administrations that wish to restrict the practice. The OECD, in the 2003 changes, has suggested a number of different treaties that address treaty shopping and so has the UN Subcommittee on Improper Use of Treaties. Against this background it is remarkable that only a small minority of the branch reports indicate that the inclusion of an LOB clause, in whichever shape or form, forms part of the tax treaty policy of the respective countries.

The inclusion of a comprehensive LOB clause in its income tax treaties has been a cornerstone of the tax treaty policy of the United States for many years. The current LOB provision is article 22 of the 2006 US model income tax convention, a provision not dissimilar to the LOB provision that can be found in paragraph 20 of the commentary on article 1 OECD MC. The LOB clause generally denies to a resident of a contracting state the benefit of the tax treaty unless certain criteria are met with respect to both the ownership of the company and the tax base. Typically, the shares in a company must be owned to a sufficient extent by qualifying residents of the other treaty country and the gross income of the company must not be eroded with deductible payments to persons that are not qualifying residents of the treaty countries, beyond a certain threshold. These ownership and base erosion rules are then supplemented with exceptions for companies engaged in a trade or business in connection with which the income from the source state is derived and by a general “bona fide” exception allowing the treaty benefits if the company was not set up primarily with a view to obtaining the treaty benefits. A further exception is made for companies the shares of which are traded with a sufficient volume on a recognised stock exchange.

Not remarkably, the branch reports from countries that do not seek the inclusion of LOB provisions in their income tax treaties, do report that the income tax treaty concluded with the United States does contain an LOB clause. The only exceptions are Hungary and Poland, but the Hungarian branch report mentions that the lack of an LOB provision in the Hungary–USA tax treaty was a predominant reason for the United States renegotiating that treaty and according to the US branch report a new treaty with a comprehensive LOB clause was initiated in 2009. Negotiations between Poland and the United States are ongoing.

Although a small minority of branch reports mention the inclusion of LOB clauses as being part of the tax treaty policy of the relevant country, the instances of inclusion seem to be increasing. The Indian branch report mentions that India is more inclined to include these clauses following the Azadi Bachao Andolan case, Japan seems to be including comprehensive LOB clauses in recent times, the Korean branch report mentions that Korea started the inclusion of LOB clauses since 2003, and explicitly mentions that Korea seems to be following the examples in the 2003 changes. Furthermore, the Russian branch report mentions that the draft Russian model income tax treaty contains an LOB provision. Finally, it is worth mentioning that according to the UK branch report the inclusion of an LOB clause is not part of UK tax treaty policy, but the report mentions that this may be changing, referring to the Qatar–UK tax treaty. However, all in all it cannot be said that the inclusion of comprehensive LOB provisions is high on the wish list of the countries from which branch reports were received.

That is not to say, however, that treaty shopping is a concern that has not been addressed otherwise. In fact, there is a great variety of tax treaty provisions mentioned in the branch reports that address specific concern for treaty shopping. Not surprisingly, the inclusion of these provisions is prevalent in treaties with countries that are likely candidates for treaty shopping. For example, the Luxembourg branch report mentions that almost all treaties concluded by Luxembourg contain a provision that excludes persons benefiting from preferential tax regimes, in particular the Luxembourg holding 1929.

The commentary on article 1 OECD MC, in paragraph 21(4), mentions anti-abuse rules dealing with source taxation of specific types of income and mentions a provision that has the effect of denying the benefits of specific articles of an income tax treaty that restrict source taxation where transactions have been entered into for the main purpose of obtaining these benefits. An example of this “main purpose” clause can be found, inter alia, in treaties concluded by Switzerland.

3.4.3. Beneficial ownership

As most income tax treaties in the world are based on the OECD MC, it is clear that the term beneficial owner is prevalent in tax treaties concluded since 1977, the year in which the term was included in articles 10, 11 and 12 OECD MC. The branch reports that elaborated on the term confirm that the term is generally not defined in treaties, although a few exceptions exist. In the absence of a treaty definition, technically the term must either be interpreted with recourse to domestic law via article 3(2) OECD MC or an autonomous interpretation must be applied. Whether that autonomous interpretation is a contextual interpretation that “otherwise requires” or a plain international fiscal meaning is the subject of some academic debate, but leaving that debate aside, the branch reports indeed show that the interpretation of the term meets with considerable difficulty. For instance, the Australian branch report mentions that “it is difficult to know what an Australian court would make of the phrase in a tax treaty context.” Austria reports that there is little guidance. Estonia and Finland have problems with the interpretation and so forth. Interestingly, the French and Swiss branch reports mention that in France and Switzerland the position seems to be, in conformity with the commentary on the OECD MC, that even if the treaty does not contain the term beneficial owner, such ownership is nevertheless a requirement for the reduction of the source state taxation pursuant to articles 10, 11 and 12. As to the choice between a domestic interpretation versus an autonomous interpretation/international fiscal meaning, the positions reported in the branch reports are mixed. In certain countries, such as the Netherlands, the United Kingdom and the United States the government position seems to be that article 3(2) provides leeway to interpret the term with refer-
ence to domestic law, but the judgment in the well-known Indofood case admitted not an ideal precedent because it was dealing with a commercial conflict rather than a tax case, clearly states that the term has an international fiscal meaning. In that case, the Court of Appeal (Civil Division) had to decide on the likely interpretation by an Indonesian court of the term beneficial owner in a hypothetical situation in which a Dutch company was interposed in a borrowing arrangement between the lenders (noteholders) and the ultimate borrower in Indonesia. As it appears inspired by the commentary on the OECD MC and by Professor Baker’s commentary on the OECD MC, the Court of Appeal considered that the contractual arrangements under which the interposed company would operate, even though as a legal matter it would not be an agent or nominee for the noteholders, would deprive it of “the full privilege to directly benefit from the income” and decided that in the hypothetical case construed, the interposed company could not be regarded as the beneficial owner. The UK branch report submits that, in spite of this decision, the term still gives rise to great difficulty in interpretation. In another well-known decision, the Prévost case in Canada, in which the beneficial ownership of dividends received by a Dutch holding company from its Canadian subsidiary was challenged by the Canada Revenue Agency, the beneficial owner was determined as the person who received the dividend for his or her own use and enjoyment and assumed the risk and control of the dividend he or she received, and the decision left open whether that meaning was a contextual, international fiscal or domestic meaning, although the court did refer to article 3(2) of the Canada–Netherlands tax treaty (but also to the commentary on article 10(2) OECD MC and to the Indofood decision). The Tax Court in Prévost also referred to the Royal Dutch case, described in the Dutch branch report, in which a resident of the United Kingdom had purchased coupons that entitled that person to a dividend subsequently paid by Royal Dutch Shell. The Dutch Supreme Court considered that the owner of the dividend coupons could freely use those coupons and, subsequent to the cashing thereof, could freely use the distribution, and in cashing the coupons did not act as voluntary agent or for the account of the principal and, accordingly, had to be regarded as the beneficial owner of the dividend. Interestingly, the Swiss and UK branch reports suggest that the interpretation of the term in Switzerland and the United Kingdom goes beyond a technical interpretation and both suggest that the term may be interpreted differently in the context of abuse. The Swiss branch report notes that in the A Holding case it was suggested that the term beneficial owner had an implied “subject to tax” requirement, whereas the UK branch report states that guidance given by HMRC following the Indofood decision clearly indicated that the international fiscal meaning provided for in Indofood would only be followed in abusive, i.e. treaty shopping, situations. A slightly different approach is followed by the Chinese tax authorities with the reported Notice 601. This notice states a number of negative elements and a review of those elements may indicate that the person claiming the treaty benefits cannot be viewed as the beneficial owner. The negative elements include an inquiry into the business activity, the assets, number of employees of the person claiming the benefits, but also whether the income is exempt from tax or subject to an extremely low tax burden in the country of residence of the recipient of the income.

68 UK branch report, at sections 1.5 and 2.4.

69 See e.g. the US branch report, at section 2.4.2.1.

3.4.4. Remittance based taxation

There is a clear pattern in the branch reports with respect to remittance clauses. Many branch reports mention that the tax treaties of their countries with Cyprus, Ireland, Malta, Singapore and the United Kingdom contain provisions that limit the benefits of the tax treaty where residents of these countries are taxable only if the income from the source country is remitted to the country of residence. Consistent with this finding, the UK branch report explicitly states that income tax treaties concluded by the United Kingdom typically contain a remittance clause.

3.4.5. Triangular cases

Paragraph 71 of the commentary on article 24(3) OECD MC mentions the case of a resident of a tax treaty state that has a permanent establishment in another treaty state to which assets such as shares, bonds or patents are transferred with a view to obtaining low taxation in the state of the permanent establishment, an exemption in the state of residence and an exemption in the state of source of the dividends, interest or royalties, as the case may be, with the effect that the resulting income may not be taxed in any of the three states. The commentary indicates that these practices may be regarded as abusive. This situation is also addressed in the report of the UN Subcommittee on Improper Use of Treaties, in paragraphs 58–61 thereof. While the described practice can be presumed to be quite prevalent, remarkably few provisions seem to be present in tax treaties to prevent the practice. The commentary suggests including a provision in the tax treaty between the state of residence and the state of source of the income stating that an enterprise can claim the benefits of the tax treaty between these states only if the income attributable to the permanent establishment is taxed normally in the state of the permanent establishment. The UK branch report notes that a provision to that effect was indeed recently incorporated in the 2008 income tax treaty between the Netherlands and the United Kingdom in article VII of the protocol. A similar provision, albeit one that aggregates the tax in the state of residence and the state of the permanent establishment for the “normality” test can be found in tax treaties concluded by the United States.

3.4.6. Other forms of perceived abuse

The report by the UN Subcommittee on Improper Use of Treaties mentions a number of transactions that modify the treaty classification of income as examples of abuse. It mentions the conversion of dividends into interest, allocation of price under a mixed contract, conversion of royalties into capital gains and the use of derivative transactions to avoid the levy of withholding tax. The review of the branch reports establishes that very few tax treaties contain provisions addressing
these forms of perceived abuse, with the exception of the case of conversion of dividends into interest. However, the case of conversion of dividends into interest described in the report by the UN Subcommittee on Improper Use of Tax Treaties, i.e. the case where a company is interposed between the payer and the recipient of the dividend with a view to converting dividends into interest payments, is not the case addressed in the tax treaties reported in the branch reports. Rather, the situations described in the branch reports are invariably (a) the preservation in the treaty of the recharacterisation of interest into dividend under applicable thin capitalisation rules, or (b) the preservation of the dividend treatment in case of payments in respect of instruments that have equity characteristics, such as contingent interest notes.\(^70\)

### 3.5. The relationship between domestic general and specific anti-avoidance rules and anti-avoidance rules in tax treaties

Even if domestic anti-avoidance rules do not conflict with the tax treaty, because they can generally be reconciled with tax treaty obligations, or specifically by virtue of a treaty provision to that effect, there is a question whether a domestic anti-avoidance rule should give way where the treaty contains a specific rule addressing the abuse. Very few reports are specific on this issue. The US branch report suggests that specific treaty rules complement domestic rules and that the domestic rules are not preempted by the treaty provisions. The Canadian report, in a somewhat different context, suggests the same, but on the other hand the German report states that a specific domestic provision would preempt a general domestic provision and a specific treaty provision would preempt a specific domestic provision.

### 4. Relationship with EU law

It is clear that anti-avoidance provisions may cause tension, or be in violation with, EU law, either the four economic freedoms or tax treaty-based general or specific anti-avoidance provisions and EU law is beyond the scope of this report. Nevertheless, branch reporters from EU countries were invited to indicate briefly, at the end of the report, to give an enumeration of domestic and/or tax treaty based anti-avoidance provisions and the relevant rule of EU law with which these may be in conflict, citing relevant case law where possible. Eleven branch reports provide for a brief discussion of the issues. The essence of a number of points raised in these branch reports is reproduced below without further elaboration.

\(^{70}\) See section 3.2 above.

\(^{71}\) On 1 December 2009, the Lisbon Treaty entered into force and the EC Treaty was replaced by the Treaty on the Functioning of the European Union. Although the cases mentioned herein are all from prior dates, and thus dealt with EC law, in this general report reference is made to EU law.

\(^{72}\) See, inter alia, ECJ cases C-264/96 (ICI), C-196/04 (Cadbury Schweppes and Cadbury Overseas), C-524/04 (Test Claimants in Thin Cap Group Litigation), C-231/03 (Oy AA).

\(^{73}\) ECJ, C-98/02.

\(^{74}\) Case C-470/04 (N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo).

\(^{75}\) Cases C-324/00 (Lankhorst-Hohorst) and C-524/04 (Test Claimants in Thin Cap Group Litigation).
so as to include interest paid to lenders resident in Germany, whereas Portugal restricted the rules so as to exclude interest paid to lenders resident in an EU Member State from their application.

CFC legislation was put to the test in the *Cadbury Schweppes* case, dealing with a UK resident company and its wholly owned Irish finance company. The ECJ decided that the attribution of profits of a CFC to a parent company, where both were resident in an EU Member State, could only be reconciled with the freedom of establishment in the case of a wholly artificial arrangement and that such an arrangement was not present if the CFC was indeed established in another EU Member State and "carries on genuine economic activities there". Several branch reports (Denmark, Germany, Portugal) mention that the domestic CFC rules were amended following the decision in *Cadbury Schweppes*, but occasionally questions remain whether the amendments were sufficient.77

Both the Austrian and German branch reports raise the issue of whether LOB provisions are compatible with EU law or restrict the freedom of establishment where "substance" requirements with respect to companies established in another EU Member State go beyond the "wholly artificial arrangement" test enunciated in the *Cadbury Schweppes* decision and the Austrian report also refers to the so-called *Open Skies* cases.78 The French report mentions that indeed the LOB provision in the income tax treaty with the United States was renegotiated recently with a view to making it compliant with EU law.

76 Above, footnote 72.
77 Danish report, under the heading "Relationship with EC law". See also the Finnish report for a domestic case decided before the *Cadbury Schweppes* decision and the subsequent change in law, at sections 1.3 and 3.
78 See section 3 of the Austrian branch report and case law mentioned in footnote 129 thereof.