**Anti-abuse Principles in Tax Treaties**

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**Improper Use of Tax Treaties**

- **Treaties are not identical and may serve different interests**
  - Different WHT rates, different rules on PE etc.
- **Treaty shopping**: a premeditated effort to take advantage of the international treaty network and careful selection of the most favorable treaty for specific purpose (e.g. relief WHT in source State, avoidance of PE)
  - Rosenbloom: “the practice of some investors of ‘borrowing’ a tax treaty by forming an entity (usually a corporation) in a country having a favourable tax treaty network with the country of source, that is the country where the investment is to be made and the income in question is to be earned”
- **Rule shopping**: taxpayer is entitled to benefits of a given treaty and employs treaty so that one distributive rule applies rather than another
  - Conversion of income schemes: taxable dividends converted in (tax free) capital gains

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**Improper Use of Tax Treaty - Case 1 - Treaty Shopping (Relief of WHT in Source State)**

- Resident of State A interposes company resident of State B to receive intra-group loan that is to be onlent to resident of State C (back-to-back intra-group loans)
- Nominal spread taxable in State B
- No tax treaty between State A and State C
- Tax treaty between State B and State C reduces interest withholding tax of State C to 5 percent
- No interest WHT in State B on payment to non-resident

- Relevance of contractual obligation?
- Analysis different if dividends?
Improper Use of Tax Treaty – Case 2 - Treaty Shopping (Capital Gains)

- Under State C domestic law non-resident is taxed on capital gains on shares in State C company
- There is no tax treaty between State A and State C
- State A company incorporates and funds a company (Y Ltd) in State B that acquires the State C shareholding.
- Tax treaty between B and C follows OECD MC: capital gains taxable only in the State of residence of the shareholder (State B)

- State B company (Y Ltd) sells and transfers Z Ltd shares to third party purchaser (B Ltd) and realizes a capital gain
- No capital gains tax levied in State B

Improper Use of Tax Treaty - Case 3 - Transfer of Effective Management

- Company resident of State A (X Ltd) owns all shares of subsidiary also resident of State A (Y Ltd)
- Parent company X Ltd becomes resident of State B under (domestic) effective management test of State B
- State B exempts dividend income under participation exemption
Improper Use of Tax Treaty - Case 3 - Transfer of Effective Management

State A

Parent company X Ltd becomes resident of State B under (domestic) effective management test of State B

State B exempt dividend income under participation exemption

Tax authorities of State A: the transfer of effective management / tax residence had as its sole purpose to avoid State A income tax at parent level on dividends to be received from the subsidiary

Israel Court: transfer of residence (based on OECD MC tie breaker) and treaty benefits can be denied

Improper Use of Tax Treaty - Today’s Discussion

- Legitimacy of treaty shopping
- Application of domestic rules
- Treaty interpretation
- Inherent anti-abuse rule in tax treaties?
- Specific anti-avoidance rules in treaty (Beneficial ownership, LOB, treaty GAAR etc.) (Not discussed today)

Improper Use of Tax Treaty

- Treaty shopping/ Rule shopping: permissible tax planning or improper use of tax treaty?
- What is improper use?
  - Nothing in OECD Model
  - OECD Conduit Report 1987 addresses the problem of treaty shopping (§7: “use is improper where a person acts through a legal entity created in a State primarily to obtain treaty benefits otherwise not available”)

- What is improper use? (cont’d)
  - OECD Commentary Art. 1 recognizes concept of improper use (§7-12) and of treaty shopping (§11 and 13-20)
    - Refers to purpose of tax treaties: “It is also a purpose of tax conventions to prevent tax avoidance and evasion” (§7)
    - No benefits for abusive arrangements (§9.4)
    - A guiding principle: “(…) benefits of a double tax convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions”
  - 2006 US Model Technical Explanation
    - Unlike prior version no definition of treaty shopping. §304 on LOB-provision: “Art. 22 contains anti-treaty shopping provisions that are intended to prevent residents of third countries from benefiting of what is intended to be a reciprocal arrangement between two countries”
  - 2009 UN Model Commentary on Art. 1 (modelled after OECD Commentary)
    - Easier to follow than OECD Commentary
    - Recognizes legal certainty and taxpayer’s right
    - Detailed examples of improper use (§42-103)
Legitimacy of Treaty Shopping – Cons and Pros

1. Improper and contrary to purposes of treaties
   - Not all structures are artificial and devoid of substance
2. Breaches reciprocity of a treaty and alters the balance of concessions
   - Some concessions are unilateral – “negotiated” balance not necessarily fair
3. Contrary to principle of economic allegiance
   - Experts do not agree on nexus required – degree involved
4. Disincentive for countries to negotiate
   - Valid (easier to achieve reciprocity + cooperation)
5. Creates undesired revenue losses
   - No evidence – encourages capital + technology inflows to source countries (developing)

Legitimacy of Treaty Shopping – Indian perspective

Azadi Bachao Andolan vs Union of India (SC - 2003)
- Tax planning is legitimate within legal framework
- Duke-of-Westminster-doctrine (UK, 1936) still prevails
- Treaty shopping is not per se illegal or unethical
- Treaty allocates taxing rights and not taxes
- Treaty may be entered for non-fiscal reasons

Developing countries may allow it as tax incentive
- Developed countries encourage for financial gain
- Double non-taxation is permitted under tax treaties
  - “Liable to tax” is not the same as “subject to tax”, in applying treaty it is not necessary for tax to be paid
  - UAE: Tax treaties with country with no taxes!
- If deemed improper need provision in tax treaty
  - Recent treaties with partial or fullLOB
- Cases: Azadi Bachao (2003, 6 ITLR 233); KSPG (2010, see case 2 with dividends and case 3 capital gains); E*Trade (2010, see case 2, 12 ITLR 701), Vodafone (2012, not a tax treaty case)

Legitimacy of Treaty Shopping – US perspective

U.S. view is that benefits of treaties it negotiates are for the residents of the countries with which it is negotiating
- Substantive reasons
- Procedural reasons (bringing other countries to the table to negotiate points important to the U.S.)
Improper Use of Tax Treaty (OECD Commentary)

**Striking down treaty abuse through application of domestic rules**

- "These States take account of the fact that taxes are ultimately imposed through the provisions of domestic law as restricted (…) by the provisions of tax conventions. Thus, any abuse of the provisions of a tax convention could also be characterized as an abuse of the provisions of domestic law under which tax will be levied. For these States the issue then becomes whether the provision of tax conventions may prevent the application of the anti-abuse provisions of domestic law (…) OECD MC Commentary Article 1, §9.2

- General Report Ifa Congress 2010, page 35: "A significant number of reports indicate that abuse of tax treaties is dealt with by applying domestic anti-abuse principles " (i.e. national GAARs)

**Striking down improper use of treaty through domestic law rule**

- French judicial view on treaty shopping
  - Treaty shopping as a form of tax planning – not illegal per se
  - Treaty shopping can be illegal:
    - Violation of treaty provision
    - Abusive act by taxpayer, according to the relevant definition of abuse
  - France: abuse of law (fictitious acts, including simulations + acts made for the sole motive of reducing the normal tax burden by applying the letter of the law against its purpose)
  - See Bank of Scotland (court made abuse of law doctrine)

**Bank of Scotland Case - France**

- Art. 31 VCLT: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose"
Striking down abuse of treaty through domestic law rule

- **U.S. judicial view**

Striking down improper use of treaty through domestic law rule

- **Netherlands – common interpretation**
  - Dutch Supreme Court searches for shared expectations of the Contracting States:
    - “Neither from the text of the treaty, nor from the explanations by the treaty partner it appears that they had the common intention to include, for the application of said article (…), under dividends income which is treated as a dividend with the application of the doctrine of fraus legis under the national law of the state in which (the distributing company) has its residence” (Dutch HR, BNB 1994/249 and 259, similar decisions: BNB 2003/285c, BNB 1995/150; HR 2006 case 39223 and others).

Striking down improper use of treaty through interpretation of the treaty

- **U.S. judicial view**
  - *Aiken Industries*, seminal treaty shopping case (facts as in slide 3) that interprets treaty language (“received by”) to deny benefits (US Tax Court, 56 TC 925 (1971)).

Striking down improper use of treaty through interpretation of the treaty

- **Canada – common interpretation**
  - Search for common/reciprocal interpretation undertaken by Canadian courts unless the other State’s interpretation is manifestly erroneous
    - Contrast *MIL* with *Crown Forest*: intervention by other State
    - In *MIL* reservation by Luxembourg on OECD MC Commentary Art. 1: absent provision in treaty, a State can only apply domestic anti-abuse rules after recourse to mutual agreement procedure should have been considered in determining abuse
    - *Prévost* and *MIL*: use of opinion of expert from other State to determine common interpretation

Striking down improper use of treaty through interpretation of the treaty

- **France - judicial view**
  - Identification of anti-avoidance purpose in tax treaty
    - Specific provision / title / preamble
    - Reluctance of French courts
      - Consul d'Etat Schneider Electric (2002, on compatibility of CFC rule with F-CH treaty, 4 ITLR 1077): alleged anti-avoidance purpose, but no specific provision contradicting Art. 7
  - Relationship between treaty anti-avoidance purpose and clear treaty attribution provision
    - Art. 31 VCLT (although France not a party): literal meaning first
    - Main object and purpose remains allocation of taxing rights
    - Does §7 on Art. 1 OECD MC justify wide notion of anti-avoidance beyond abuse?

Inherent anti-abuse principle in tax treaties?

- Art. 26 and 31 VCLT: Can treaty benefits be denied based on good-faith-application/ interpretation?
  - ICJ dissenting opinion Judge Alvarez
    - But no actual application by ICJ and agreement as to whether it is a general principle of international law
  - Abuse of law is a general principle of EU law also in tax matters (Kofoed, C-321/05; Foggia, C-126/10)
  - Vogel & Ward
  - Art. 26 obligation governing interstate relations, applicable on the forum where taxpayer and tax authorities operate?
  - Case law
    - Not present: MIL (facts, see slide 6-7) and Dutch Supreme Court (various cases)
    - Present: A Holdings (facts see slide 3, 8 ITLR 537) and Yanko Weiss (facts see slide 6-8, 10 ITLR 524)
  - Art. 31 VCLT good faith interpretation of international treaties by Courts
    - A better argument than the one based on Art. 26 VCLT?

Summary and Conclusions

- On very similar fact patterns courts in different jurisdictions (and even in the same jurisdiction) come to diametrically opposite results
- Not satisfactory
- Reasons?
  - Appreciation of facts
  - Judicial methodology
  - Different approaches to fundamental questions (e.g. inherent anti-abuse rule, interpretation of BO)
  - Different policies of States towards tax avoidance and treaty shopping
  - Willingness of courts to rely on Commentary and to apply posterior Commentary to earlier treaties

THE LISBON INTERNATIONAL & EUROPEAN TAX LAW SEMINARS

**UPCOMING SEMINAR – 19.04.2012**

**IMPACT OF MULTILATERAL TAX CONVENTIONS ON BILATERAL TAX TREATIES**

Prof. Dr. PASQUALE PISTONE (WU Vienna/Uni. Salerno)

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This article summarizes the contents of Subject 1 of the 64th Congress of the International Fiscal Association Congress held in Rome on 30 August 2010, which considered issues relating to tax treaties and the application of anti-avoidance measures.

1. Introduction

The topic of Subject 1 (the "Subject") at the 2010 International Fiscal Association annual congress held in Rome, Italy, from 29 August to 3 September, was "Tax treaties and tax avoidance: application of anti-avoidance provisions." In this regard, the Subject considered this topic from the following two perspectives: (1) domestic anti-avoidance and tax treaties; and (2) abuse of tax treaties or treaty shopping.

2. Outline of the Discussion

In 2003, the OECD revised the Commentary on Article 1 of the OECD Model (2003) (the "Commentary (2003)" in general) and concluded that general anti-avoidance rules (GAARs), substance-over-form and economic substance measures are part of the basic domestic rules for determining which facts give rise to a tax liability. Such rules are not addressed in tax treaties and are, therefore, not affected by them. The Commentary (2003), therefore, concludes that, as a general rule, there is no conflict between GAARs and other similar measures and judicial doctrine and tax treaties. The revised Commentary (2003) also concludes that controlled foreign companies (CFCs) legislation does not conflict with tax treaties, in particular, not with the text of articles 7(1) and 10(5) of the OECD Model (2003), interpreted in their context. Accordingly, there is no need to preserve the application of CFC rules in tax treaties.

In the striking down of abuse of the tax treaty itself, the revised Commentary on Article 1 of the OECD Model (2003) offers a guiding interpretation principle in that the benefits of a tax treaty should not be available where a main purpose for entering into a certain arrangement was to secure a more favourable tax position and obtaining that more favourable treatment in circumstances would be contrary to the object and purpose of the relevant treaty provisions. The revised Commentary (2003) distinguishes two groups of countries. The first group includes the many countries that take account of the fact that taxes are ultimately imposed through the provisions of domestic law as restricted by the provisions of tax treaties. For these countries, abuse of the tax treaty amounts to an abuse of the provisions of domestic law under which tax is assessed. The issue, therefore, becomes whether or not the provisions of tax treaties may prevent the application of the anti-abuse rules of domestic law. In view of the OECD's position summarized in the previous paragraph, it is not a surprise that the Commentary (2003) answers this question affirmatively. A second group of countries view some forms of abuse as abuses of the tax treaty itself as opposed to abuses of domestic law. According to the Commentary (2003), these countries consider that a proper interpretation of a tax treaty allows them to disregard abusive transactions, such as those entered into with the view of obtaining unintended treaty benefits. This interpretation is derived from the object and purpose of the tax treaty and the obligation to interpret it in good faith under article 31 of the Vienna Convention of the Law of Treaties (1969) (the "Vienna Convention (1969)").

The 2009 UN Report on Improper Use of Tax Treaties (the "UN Report (2009)"") agrees with the OECD view in principle, but with certain important exceptions. It puts more emphasis on the needs of developing countries, such as source taxation, capacity building and the role of tax treaties in allocating taxing rights to avoid double taxation. Unlike the OECD Commentaries, the UN Report (2009) recognizes that both legal certainty and the
rights of taxpayers should be balanced with the need for tax administrations to avoid abuse and fraud. The tax treaty mechanisms are designed to prevent this abuse in borderline situations where the treaty's wording is not clear. The discussion is centered on the application of domestic anti-avoidance rules and their impact on the interpretation of the outer limits of the treaty provision.

The presentation of the subject is divided into three parts. The first part, the General Reporter summarizes the main findings of the Reference Report. The conclusion are set out in section 3. The next part addressed the application of GAARs and special anti-avoidance rules (SAAARs) to arrangements with international implications and their relationship with tax treaties. The analysis of these rules is concluded in sections 4. The third part of the discussion concerned the abuse of the treaty itself and addressed the question of whether or not such abuse is dealt with under domestic law or whether it is covered by the treaty apparatus in the treaty's object and purpose. It also dealt with treaty provisions that allow the application of domestic anti-avoidance provisions and with general and specific anti-avoidance provisions in tax treaties. This part of the discussion is summarized in section 5.


The General Report on the subject matter was written by Prof. S. van Weeghel (2010) and is based on more than 44 branch reports. The following are the main findings of the General Report:

- Where GAARs or judicially developed anti-avoidance doctrines are concerned, the statements in the Commentary on Article 1 of the OECD Model (2003) regarding the relationship between domestic anti-avoidance measures and tax treaties are generally endorsed by countries, although there are some significant exceptions, for example, Luxembourg, the Netherlands and Portugal. 11
- SAAARs such as CFC and thin capitalization rules, exit taxes on shares and accrued pension rights, specific recharacterizations of income and fictions can sometimes be reconciled with a state's treaty obligations, but the branch reports contain many exceptions. In this context, it is of importance to distinguish countries that constitutionally can override tax treaties, for example, Australia,
- Germany and the United States and those that cannot. 12
- When it comes to curbing abuse of the tax treaty, practical differences occur considerably. According to some branch reports, for instance, in Flanders, it is not possible to recognize a general anti-abuse principle that would be inherent in every tax treaty, which would allow the striking down of alleged abuse by itself. Other reports clearly express the view that abuse of a tax treaty must be addressed through interpretation of the tax treaty itself and, in particular, recourse to the general interpretation rule of article 31 of the Vienna Convention (1969). In applying this theory, some courts in some jurisdictions review the object and purpose of the tax treaty in line as well as of the treaty provision at state (see, for example, the Canadian case of Antle v. Her Majesty the Queen (2009).) However, a significant number of reporters take the position that abuse of the tax treaty itself can be dealt with by applying domestic anti-avoidance principles. 14
- The most prevalent abuse of the tax treaty itself is treaty shopping. An overview of the case law in the various countries surveyed shows a striking array of different outcomes. In some instances, courts concluded on the basis of the principle of pacta sunt servanda that the treaty benefits ought to be given, whilst courts in other jurisdictions have held that the treaty does not apply for reasons that fit on the principle of economic substance or because the transaction was tax driven.
- Very few tax treaties explicitly preserve the application of domestic GAARs. However, most tax treaties preserve the application of domestic SAAARs. Relatively few tax treaties contain GAARs according to which treaty benefits are denied if, for example, the main purpose of the transaction is to obtain such benefits. However, many do include specific anti-avoidance rules. In the attempt to counter treaty abuse by conduit companies, the "beneficial ownership" clauses in articles 10-11 and 12 are clearly the most important anti-avoidance rules which countries have systematically included in their tax treaties since 1977. Recently, courts in several jurisdictions, for example, Canada, India, the Netherlands, Switzerland and the United Kingdom have been asked to interpret this expression. An analysis of this case law reveals that courts have not always faced difficulties with the interpretation of this term.

4. Domestic Anti-Avoidance Rules, Cross-Border Arrangements and the Relationship with Tax Treaties

4.1. Introductory remarks

The discussion started with an overview of the changes introduced in 2003 to the Commentary on Article 1 of the OECD Model (2003) and the UN Report (2009) (see section 2). The general feeling was that UN Report (2009) attempts, more than the Commentary (2003) does, to strike a balance between the need for the tax authorities to protect their tax revenues and the need to provide legal certainty to taxpayers who often invest much needed resources in developing countries. According to the panel, the UN Report (2009) was easier to follow than the Commentary (2003) and the inclusion of detailed examples of improper use of tax treaties in the UN Report (2009) was welcomed.

The panel's discussion was illustrated by two cases that have been decided by courts in several jurisdictions. The first case concerns the application of CFC rules (see section 4.2) and the second the application of GAARs and/or SAAARs to structures that are intended to convert taxable dividends into non-taxable capital gains on shares (see section 4.3).

4.2. Case 1: SAAARs - CFC legislation

4.2.1. Facts of the case

The relevant scenario is as set out in Diagram 1.

4.2.2. Objective and techniques of CFC legislation

The primary objective of CFC legislation is to eliminate the sheltering of income in a corporation based in a low-tax jurisdiction (the CFC) and the resulting tax deferral in the residence state of the shareholder. All CFC legislation applie......
CFC legislation does not amount to a taxation of actual income of the Netherlands CFC in the hands of the UK parent, a conflict between the CFC legislation and the tax treaty cannot arise.

Sweden extended its CFC rules in 2004. However, at the same time, following the change in tax law in Sweden, the Netherlands challenged the CFC rules on the basis of Arts 9 and 11 of the Treaty between the Netherlands and Switzerland (1963). The Court explicitly noted that Sweden was a duellistic country. Accordingly, a Swedish statute implementing a tax treaty has no special, i.e., superior, status compared to other statutes. Consequently, the Court found that Sweden is not precluded from extending its taxing rights by way of a subsequent statute in a way that may be a breach of the provisions of its tax treaties. The Court appears to suggest that the Swedish CFC rules do conflict with article 7 of the tax treaty. However, it did not attempt to reconcile the CFC rules with Sweden’s tax obligation, but, rather, endorsed a treaty override.

Canada’s treaty practice is to specifically override its treaty provisions in all but four of its 87 tax treaties. Such a clause suggests that Canada’s treaty negotiators are, unlike the Commentary (2003) to which Canada did not attach any weight, aware of a potential conflict with the domestic CFC rules and its treaty obligations. Canada’s specific override provision has been interpreted very narrowly. In the words of the UK Court, Canada merely provides a measure by which a notional sum is calculated and apportioned to the UK shareholder and on which the UK tax is charged. As the Court found that the UK

CFC legislation was not disproportionate and, consequently, did not violate the tax treaty’s object and purpose, as it provides for a tax where the CFC carries on a genuine independent economic activity. Earlier, the Finnish Supreme Administrative Court (Karkain hallintoliitto, KHK) in Oy Ahv (2002) had held that, under the Finnish CFC legislation, the subsidiary that is attributed to the Finnish parent is to be characterized according to the activities of the subsidiary and the particular circumstances of the case. If found that, in the case in question, the attribution of the CFC profits gave rise to a contradiction in taxing the United Kingdom

4.3.2. Discussion of the case law

In the Netherlands, the judiciary developed the doctrine of "fraus legis" (abuse of law) permits a purely domestic setting the recharacterization of the capital gain into a dividend or capital gain for the benefit of the selling shareholder.

4.3.3. Discussion of the case law

Under the Singapore-Dutch tax treaty of 2005 the Singapore-Dutch tax treaty was amended and CFC income is now characterized as a deemed dividend. In the previous decision, the treatment was (subject to a high "kick-out") as a result, the US parent is taxed under the Subpart F regime and the US position is that Subpart F income is, therefore, outside of the scope of its tax treaties including the income of the CFC. The US, however, has not challenged at all the existence of the CFC.

Following the decision of the Council d’État in Schneider, in 2005, the French CFC legislation was amended and CFC income is now characterized as a deemed dividend.43 In that decision, the discussion centres around the question of whether a deemed dividend has been paid. As a matter of principle, agreement was reached by the Court of Justice in article 10 or article 21 of the French tax treaties that follow the OECD model (in which case France as the resident state is to be taxed in respect of the dividend paid to the CFC) or whether it is outside of the scope of the tax treaties (in which case there can be no conflict between domestic law and the tax treaty). However, article 7 still applies, as the French tax treaties do not provide for the allocation of the tax on the undistributed profits of the subsidiary. It also raises the more fundamental question of whether or not such a fiction, which is enacted to circumvent the tax law that is unfavourable to the shareholder, is to be applied to CFCs based in countries with which France signed a tax treaty before the enactment of the fiction.

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a resident of a treaty state and Y Ltd is a resident of the Netherlands, on several occasions the Netherlands Supreme Court (Hoge Raad) has held in cases involving the Belgium-Netherlands Treaty and Capital (1970) and the Netherlands-United States Income (1992) tax treaties that it did not follow from the text of the treaty nor from the explanations by the treaty partners that they had the common intention to include for purposes of article 10 under the term “dividend” income that was treated as a dividend under the Netherlands domestic doctrine of “pugnus legis.” Consequently, the Supreme Court attaches important weight to the shared expectations of the two contracting states in assessing the compatibility of the Netherlands judicially developed anti-avoidance doctrine with the Netherlands treaty obligations and refuses the application of this doctrine to a treaty situation where there is no evidence that such an application agrees with the shared expectations of the treaty partners.

Under the US Internal Revenue Code (IRC) the scheme is treated as a dividend paid by X Ltd to P. Under the IRC, such a dividend paid by a foreign corporation to a US shareholder is taxable as a dividend to the extent of the US shareholder’s proportionate share of the corporation’s earnings and profits. Accordingly, this recategorization of the related party stock sale occurs as a matter of US domestic law. The recategorized transaction would then be subject to the applicable treaty rules, for example, to the extent that the distribution is taxable as a dividend. The dividend could qualify for a reduced rate of withholding under an applicable income tax treaty. In 2010, the United States enacted a codified “economic substance doctrine,” which purported to “clarify” the standard to be used by courts. The codified doctrine requires that, with respect to any transaction to which the doctrine is relevant, the transaction must have a substantial purpose and must change the taxpayer’s economic position in a meaningful way. An codification has been the law for less than a year, how it will be applied by tax authorities and the courts is not clear.

In Canada, a scheme like case 2 is also restricted by a SAAR. In R.M. Canadian Enterprises Inc. et al. v. Her Majesty the Queen (1997), the Tax Court of Canada held that the recategorization of the capital gain into a dividend distributed by X Ltd to P under the SAAR could be upheld for treaty purposes (Canada-United States Income and Capital Tax Treaty (1980)). In an obiter dictum, the Court also stated that such a recategorization would be possible under the Canadian GAAR and that the tax treaty did not restrict the operation of the GAAR. In this regard, the Court observed that the term “alienation” in article 13 of the treaty (Capital gains) refers to a “genuine alienation and not one that is made to an accommodation party as an integral part of distribution of such surplus.” The Court also held that the definition of “dividend” in article 3(3) of the tax treaty was broad enough to include a recategorized dividend, as the definition includes “income subjected to the same taxation treatment as income from shares by the taxation laws of the State of which the company making the distribution is resident.” The Court further concluded that whether or not a recategorized dividend is treated as income of the company making the distribution is a matter of residence. In this regard, the Court concluded that its interpretation was consistent with that of the contracting states, as neither Canada nor the United States had reserved on article 10 of the OECD Model (1977) and the Commentary (1977).

Paragraph 28 of the Commentary on Article 10 of the OECD (1977) states that the word “dividends” as used in article 10 includes diagnosed distributions of profits as a result of the tax treaty’s residence state of the company making the distribution. The Court further observed that neither Canada nor the United States reserved on article 10 of the OECD Model (1977) nor observed on the Commentary (1977). In an additional obiter, the Court stated that article 3(2) of the Canada-United States Income and Capital Tax Treaty (1980) also allows the application of the GAAR.

India will introduce a GAAR into its tax code in 2011. It is believed that in the opinion of the legislator the GAAR is to be applied to alleged abusive structures involving India’s tax treaties. It is not certain whether or not the Indian treaty situation would allow a recategorization of X Ltd’s capital gain into a dividend in a scheme similar to Case 2.

The discussion in R.M. Canadian Enterprises Inc. et al. v. Her Majesty the Queen (1997) reveals that the application of GAARs and SAARs to cases that are governed by the provisions of tax treaty may be facilitated by case law. Consequently, it is clear that for treaty purposes, such as in the case of domestic law, such as article 3(2) or article 10(3) of the OECD Model (2010) or the UN Model (2006). The UN Report (2009) states that it follows from article 3(2) that the application of domestic anti-abuse rules affects how treaty provisions are applied, rather than producing conflicting results.

However, the panel expressed serious doubts as to whether or not article 3(2) of the OECD Model (2010) permits recourses to CAARs or domestic anti-abuse doctrines. Article 3(2) allows the application of domestic law definitions where terms are not defined in the tax treaty, subject to the proviso that the “tax treaty context does not require otherwise.” The panel observed that it follows from the ordinary meaning of the terms of article 3(2) that this provision concerns with definitional rules of domestic law. As far as its context, both the internal and external context of article 3(2) suggests that this provision only allows the application of domestic definitions. With regard to the internal context, it should be noted that article 3(2) forms part of chapter II of the OECD Model (2010) that deals with “definitions.” Other treaty provisions also permit recourse to domestic law, for example, article 10(3) of the OECD Model (2010) and of the UN Model (2006) and do not limit such recourse to definitional provisions, as article 3(2) does. With regard to the external context of article 3(2), it should be noted that the Commentary on Article 3(2) of the OECD Model (2010) permits the application of domestic definitions, but not of substantive provisions of domestic tax law permitting recharacterization of income or redetermination of taxpayers. The panel, therefore, concluded that article 3(2) does not allow the application of substantive provisions of domestic tax law. In this respect, the panel observed that the Canadian GAAR is a recharacterization proviso rather than a definitional one. This is also true for GAARs in many other jurisdictions. In other jurisdictions, GAARs are not definitional either, but, rather, mere rules of evidence setting out the conditions under which the tax authorities have a right to set aside tax avoidance schemes. Under doctrines like sham, substance over form and abuse of law (pugnus legis) and certain GAARs, tax authorities are also permitted to analyze the true nature of the transaction or arrangement and assess tax on such a true nature as characterized to allow tax taxation in accordance with the object and purpose of the rule that the taxpayer sought to circumvent. Such doctrines and GAARs are not definitional. Rather, as the paragraph 21.1 of the Commentary on Article 1 of the OECD Model (2010) states, these doctrines and GAARs are concerned with “determining which facts give rise to a tax liability.” It is, therefore, questionable whether or not the ordinary meaning of the terms of article 3(2) of the OECD Model (2010) construction context allows the application of GAARs and these doctrines.

With regard to the particular issue of whether or not the application of SAARs is permitted under tax treaties, the panel observed that, in many cases, SAARs are not rules that determine the tax liability, but are, rather, a fictitious presentation of facts for tax purposes. They represent a way of administering the tax system more than providing a definition of a concept. With regard to the application of CAARs in relation to tax treaties, the panel proposed to analyze first whether the tax treaty includes an autonomous definition, in particular of the income which a country seeks to tax, or allows the application of substantive provisions of domestic law. For example, article 10(3) of the OECD Model (2010) and whether the application of the SAARs is in line with such a definition. As CAARs have recourse to domestic law. If this is not the case, it must be analyzed on a case-by-case basis whether the SAAR is a definitional tax regime (substantive tax provision). Only in the former case may article 3(2) of the OECD Model (2010) offer a ground to apply the SAAR, unless the context of the tax treaty would require otherwise.
C (Z Ltd). State B taxes Y Ltd on the basis of a nominal spread. There is no tax treaty between State A and State C. The State B-State C Tax Treaty reduces interest withholding tax of State C on interest paid by Z Ltd to Y Ltd to 5%.

5.3. Case 4: treaty shopping – capital gains arrangement

The relevant scenario is set out in Diagram 4.

Under State C domestic law, a non-resident shareholder is taxed on capital gains on shares in a State C resident company. There is no State A-State C Tax Treaty to shelter a State A resident shareholder from such capital gains tax in State C. A State A resident company (X Ltd) incorporates and funds a company (Y Ltd) in State B that acquires the State C shareholding (Z Ltd). The State B-State C Tax Treaty follows the OECD Model (2010) and provides that capital gains realized by Y Ltd in respect of its shareholding in Z Ltd are only taxable in the shareholder’s residence state (State B). However, under its domestic laws, State B does not levy capital gains tax. In this case, Y Ltd sells and transfers Z Ltd shares to a third party purchaser (B Ltd) and realizes a capital gain that is tax exempt in State B and that is sheltered from State C tax under the State B-State C Tax Treaty.

5.4. Legitimacy of treaty shopping

Before discussing Cases 3 and 4 (see sections 5.2 and 5.3., respectively), the panel addressed the issue of whether or not treaty shopping constitutes a legitimate use of the treaty network. This discussion is summarized in the Table.

The panel concluded that the "big picture" balancing argument is only valid with regard to a tax treaty between comparable states with the same bargaining power and the same inbound and outbound investment flows.

The panel then further explored the policy of treaty negotiators and the judicial view in certain states as to the legitimacy of treaty shopping. At one end of the spectrum is the United States whose view is that the benefits of tax treaties should only be available for the residents of the states with which the US negotiates tax treaties. To this end, the United States advances substantive reasons and practical reasons. The substantive reason is that the United States wants to provide treaty benefits only to states with respect to which there is a real threat of double taxation. If the United States allowed treaty shopping, it would allow its tax treaty to be avoided by residents of a state of whose tax system it may know nothing, thereby raising the prospect that the tax treaty benefitted income which would, without the tax treaty, suffer no double tax or no tax at all. From a practical perspective, the US position allows it to bring the states of the shareholders controlling the interposed entity to negotiate points that are important to the United States thereby realizing reciprocity and mutual assistance in tax matters (see point 4. of the Table). At the other end of the spectrum is India. In Union of India and another v. Azad Bachoo Andolan and another (2003), the leading case on treaty shopping, the Indian Supreme Court held that treaty shopping is not illegal or unethical per se. Relying on the doctrine expressed in the UK case of IRC v. Duke of Westminster (1953), the settled view of the Supreme Court is that tax planning complying with the text of the Indian statutes and tax treaties is legitimate. Tax treaties allocate taxing rights between the two contracting states, not taxes. Accordingly, the application of provisions of tax treaties to cross-border arrangements may result in double non-taxation. Such a result does not infringe the provisions of tax treaties nor their object and purpose. India even enters into tax treaties with States levying little or no tax, such as the India-Mauritius Income and Capital (1982) and the India-United Arab Emirates Income and Capital (1998) Treaty. *54* Treaty benefits are available.


52. Treaty benefits are available.


<table>
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<th>Table: Summary of whether or not treaty shopping is legitimate</th>
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<td>Arguments against treaty shopping</td>
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<tr>
<td>1. Improper and defeating the purpose of tax treaties</td>
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<td>2. Breaches reciprocity of the tax treaty and alters the balance of concessions</td>
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<td>4. Disincentive for states (of entity controlling the conduit) to negotiate tax treaties with source state.</td>
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<td>5. Creates undesired loss of revenues in source state.</td>
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able to residents of the contracting states. A person is a resident of a contracting state if he is "liable to tax" in that state (section 4 of the article 6 of the OECD Model (2010) and/or UN Model (2001)). "Liable to tax" does not mean that the person should actually pay tax on some income in that state. An interpretation would need to confirm the expressions "liable to tax" in the context of the tax treaty. Tax treaties may be entered into for other reasons than tax related reasons. India’s tax treaties, for example, often include clauses to promote economic relations, trade and investment. Against this background it is understood that developing countries may allow treaty shopping as a means to attract foreign investment. If treaty shopping is regarded as being illegitimate, anti-abuse measures should be specifically included in the tax treaty. This explains why India in some of its tax treaties, and currently in the case of other clauses, is prepared to include full or partial LOB clauses.

Canadian and French courts appear to take more intermediate positions. In Crown Forest Industries Ltd. v. Her Majesty the Queen (1995), the Canadian Supreme Court appears to have set out an interpretive framework against treaty shopping:

Although there is nothing improper with choosing the most beneficial international tax regime, it should not be encouraged or permitted by treaty provisions. Treaty shopping... would be contrary to the basis on which Canada has agreed to tax the source country, namely that the US resident is subject to tax in the US. However, later in Mill Investments S.A. v. Her Majesty the Queen (2007), the Tax Court of Canada expressed the view that:

there is nothing improper with selecting one foreign regime over another... the shopping or selection should not be minimized to the extent that its own cannot be viewed as being abusive. It is the use of the selected foreign regime that is viewed as improper.

In France, treaty shopping is regarded as just another form of tax planning, which is not illegal per se. Treaty shopping can be illegal where the provisions of a tax treaty are infringed or where the act of the taxpayer is found to be abusive under the domestic law rules of abuse of law ("abus de droit"). Abuse of law under French tax law may include not only fictitious acts and sham transactions, but also anything that comply with the letter of the statute but defeat its purpose, as these are the core purpose of reducing the normal tax burden. In Bank of Scotland v. Ministre de l’Economie, des Finances et de l’Industrie (2006) which interpreted the concept of the French-U.S. United Kingdom Income Tax Treaty (1988), discussed further in section 5.5.4. The Conseil d’Etat applied the abuse of law doctrine to a case of alleged treaty abuse.

5.5. The "tool box" for countering treaty abuse predominantly treaty shopping

5.5.1. Initial comments

The General Report makes it clear that countries attempt to strike down abuse tax treaties and treaty shopping in particular in at least four different ways (1)

through the application of domestic anti-abuse measures; (2) through the interpretation of the provisions of the tax treaty; (3) by relying on an anti-abuse rule that is implied under the tax treaty; and (4) by developing specific anti-abuse measures in their tax treaties. These measures may be combined or make a combination of these measures. For instance, in the United States, a relatively simple case of a pass-through entity investing in another jurisdiction, the abuse involves the following rules and doctrines: (1) domestic anti-abuse, developed judicial doctrines, for example, business purpose, economic substance and step-transaction (see section 5.5.2.); (2) anti-abuse anti-treaty rules, not respected and treaty rules, for example, the United Kingdom-United States Income and Capital Tax Treaty (2001), (3) IRC and treaty rules on bare opinion of income and arm’s length rules; (4) de minimus rules; (5) form of entity rules; (6) treaty rules on residence and subject to tax; (7) treaty anti-abuse rules, such as LOB and beneficial ownership, the meaning of which is further explained in domestic regulations; (8) the interpretation of treaty provisions to prevent abuse as in Aiken Industries, Inc. v. Commissioner of Internal Revenue (1971)" (see section 5.5.3.); and/or (9) the application of anti-avoidance relevant rules, for example, contingent interest rules.

Recently, a number of important treaty shopping cases involving fact scenarios similar to Cases 3 and 4 (see sections 5.2. and 5.3.) have been heard by the courts in jurisdictions around the world. The approach to the facts of the cases, and the reasoning adopted by the courts provides for an array of diverging positions.

5.5.2. Domestic anti-abuse measures

In line with paragraph 9.1. of the Commentary on Article 1 of the OECD Model (2003) (see section 1.), many countries consider that an abuse of their tax treaties should be characterized as an abuse of their domestic laws by which the taxes are assessed. Accordingly, these countries take the view that the abuse of a tax treaty can be cured through domestic anti-abuse measures and in particular GAARs and judicially developed doctrines. In France, for example, the abuse of law doctrine is codified in article 64 of the French Tax Procedures Code (Loi des Procédures Fiscales). In India, for example, the domestic tax act (not involving the application of a tax treaty) that an abusive situation that falls outside the scope of the tax treaty, but whose evasion the treaty cannot prevent. The law doctrine is a general principle of French law that is close to the EEC’s case on abuse of Community law in tax matters (see further below). In France, the Court of Cassation also decided that the domestic abuse of law doctrine could be applied to a case concerning an alleged abuse of the France-United Kingdom Income Tax Treaty (1968) if it is established that the arrangement is set up for the sole purpose of obtaining the benefits of the tax treaty. The Court relied on its doctrine of abuse of law to construe the term "beneficial ownership.

In the United States, the tax authorities have, on several occasions, attempted to curb treaty shopping schemes by making use of one of the many domestic anti-abuse measures. India, Indiana Public Service Company v. Commissioner of Internal Revenue (1957), a US company, incorporated a wholly-owned subsidiary in the Netherlands Antilles. This subsidiary issued shares that were traded on the stock market for an amount of USD 70 million, bearing interest at 17.25%. The Netherlands court, however, sustained the US component of the judgment that the arrangement was not free of tax. The US Internal Revenue Service (IRS) did not deny the treaty benefits based on an interpretation of the terms of the tax treaty. Rather, the IRS relied on the domestic doctrine of business purpose and application of courts distinguished the facts of NIFSCo from Aiken Industries. Specifically, the Court of Appeal held that the Netherlands Antilles company was determined to conduct a recognizable business activity, although minimal, and to realize a profit on its lending activity and that it borrowed from unrelated parties. The Court did not accept the difficulty with the fact that this business is an "abusive act" aimed to a minimal involvement in a back-to-back financing arrangement that was intended to avoid US withholding tax. In Del Commercial Projects, Inc. v. Commissioner of Internal Revenue (2001), the US Supreme Court held that the "step transaction doctrine", which is another domestic anti-abuse doctrine, to deny treaty benefits. Under this doctrine, a particular transaction is determined to be regarded if the taxpayer could have achieved his objective by a different, but included the step for no other purpose than avoiding US taxes. Relying on this doctrine, the IRS contended that the US-source interest should be regarded as having been paid to a Canadian group company rather than to an incorporated Canadian affiliate, thereby, denied the exemption of US withholding tax. In this case, the US courts held that the United States Income Tax Treaty (1992). The US Court of Appeal held that:

- the sole purpose of the transaction with a foreign corporation is the avoidance of US tax on the dividends, the taxpayer cannot avoid the US tax liability by relying on the anti-treaty doctrine. The taxpayer's case rests on the notion that the treaty should apply to the non-taxed income. This is a new and substantial interpretation of the treaty, but it has been denied. The US domestic tax provisions of the Netherlands Antilles United States Exchange of Information treaty (1960) and the international anti-treaty provisions of the treaty have not sufficient business or economic purpose.

According to the US Court, the purpose of applying the step transaction doctrine, the Court’s ruling appears to be based on major flaws in form and substance. Hence, the Court also found that the arrangement was no longer on its own account that the loan commitment in reality paid interest to the Canadian ultimate beneficiary rather than to its purported Netherlands creditor.

5.5.3. Interpretation of treaty provisions

One of the many instruments used by the tax authorities in the United States is the interpretation of the terms of a tax treaty in such a way that the abuse of the provisions of the tax treaty is prevented and that the United States is not forced to give the treaty benefits which such benefits are not intended. In the United States, Aiken Industries is the leading case that interprets the words of a tax treaty to deny the benefits where the arrangement is found to frustrate the object purposes of the provisions. The case concerned the payment of interest by a US company to a Honduran company that was interposed between the initial lender (a Bahamian affiliated company) and the US borrower. The Honduran company was contractually bound to pay on the interest received without making a profit margin. This was clearly a last resort tax planning scheme designed to avoid US withholding on direct interest payments to the initial Bahamian lender. The US Tax Court decided that the interest was not "received" by a corporation resident of Honduras as required by the United States Exchange of Information Treaty (1960) and thus denied the benefits of the tax treaty. The Court stated that the term "received" by means:

Various decisions by the Netherlands Supreme Court appear to mirror its belief that tax treaties do not include an inherent anti-abuse principle.25 The Tax Court of Canada in its investment decision likewise.

These decisions must be contrasted to the Swiss X Aps (2005) case due to the similar structure of tax treaty 3 (see section 5.2). However, the flow of income is dividends rather than interest. The Swiss Federal Supreme Court (SFS) decided that a Danish holding company receiving Swiss dividends could not claim the benefit of the Swiss reduced withholding tax as the structure abused the Denmark-Switzerland Income and Capital Tax Treaty (1973).26 The Court found that the Danish company was a mere letterboxinterpersed between its Guernsey and ultimately Bermuda shareholders to claim the tax benefit. The good faith dividend holding had no offices or staff, nor any other assets that the shares in the Swiss company. It observed that its judgement would have been different had there been economic reasons justifying the intermediation of the Danish company. The Court essentially based its decision on the existence of an inherent anti-abuse principle in tax treaties which it derived from articles 26 and 31 of the Vienna Convention (1969) and the writings of Vogel (1997). Specifically, the Court stated that:

the prohibition of abuse is part of the principle of good faith... It is therefore apparent that its purpose is to prevent this abuse from being resorted to. Accordingly, the prohibition of abuse of rights as regards conventions is not only realized in the wording of the principle of good faith but also on the European level without being necessary to adopt an explicit prohibition of abuse of rights in conventions (...). Additionally, the principle of abuse of rights is, recognized by Denmark. (Authors unofficial translation)27

The Swiss case, must in turn, be compared to the Canadian case of Pierre Car.28 The taxpayer was a Canadian company owned by a Dutch company. The Dutch company, in turn owned by a UK and a Swedish company. The UK and Swedish companies entered into a shareholder’s agreement to determine the share of owners of what would be paid by the Netherlands company, subject to the finances of the company. The Tax Court of Canada, whose decision was confirmed by the Canadian Federal Court of Appeal, found that there was no evidence that the Netherlands company was a mere conduit to the UK and Swedish shareholders. In this respect, the Tax Court took account of the fact that the shareholders had no means of enforcing their agreement against the Netherlands company and that the latter was under no legal obligation to declare a dividend. Accordingly, the Tax Court found that the Netherlands company was the beneficial owner of the dividends received from its Canadian subsidiary. No argument was made that the structure abused the Canada-Netherlands Income Tax Treaty (1986).29

In Yanko-Weiss Holdings (1996) Ltd. v. Assessing Officer of Income (2007), the District Court of Tel Aviv also found that the Belgium-Israel Income and Capital Tax Treaty (1972),30 which does not provide for specific anti-avoidance rules or specifically allows the use of domestic anti-avoidance rules, comprises an implied anti-abuse rule. The case concerns an alleged abusive “artificial” the term used in Israeli domestic law) transfer of the seat of effective management of a company from Israel to Belgium in anticipation of the receipt of dividends that would enjoy the special exemption in Belgium. The Court’s reasoning is not easy to follow and its line of thinking appears to be two-fold. First, it observed that the tax treaty prevents the application of the Israeli GAAR. According to the Court, “the determination of the liability is set forth first and foremost by domestic law. The domestic law gives effect to the treaty... in order to set forth the scope of tax liability in a manner such that there will not be exposure to double taxation”.31 Second, the Court noted that it follows from article 21 of the Vienna Convention (1969) that there is no “fixed” tax rate. Accordingly, it had no difficulty in not being used for improper purposes, i.e. to claim benefits under schemes which are merely tax driven. However, it is not clear whether the Court viewed the use of the domestic GAAR to an alleged abuse of the tax treaty as a consequence of the existence of an implied anti-abuse rule in the tax treaty or whether the Court believed that there were two independent grounds on which the Israeli tax authorities could disregard the transfer of the company’s residence. Israel was not a member of the OECD when the tax treaty was signed but at the time of the judgement. However, did not find from saying that, although the Commentary (2003) is not binding, it has “substantial weight as to matters of interpretation”. Accordingly, it had no difficulty in applying the Commentary (2003) to a tax treaty signed in 1972 and to a transaction carried out in 1999. It should be noted that the OECD’s Commentary (2003) was limited to the question of whether or not the Israeli tax authorities could deny the benefits of the tax treaty to the alleged abusive transfer of residence. The questions of the damages calculation and the source of residence, and whether the company had become a Belgian resident under article 4 of the tax treaty was to be decided at a later stage.

25. See, inter alia, the case law quoted in supra n. 9.
27. Connection Between the Better Confederation and the Kingdom of Denmark for the Avoidance of Double Taxation - The Case of Permanent Establishment with Respect to Taxes on Income (22 May 1980) in respect of the period 1979/80. The Supreme Court of the State of Israel for the Avoidance of Double Taxation with respect to Taxes on Income and Capital National (1979).
The panel closed the discussion by referring to paragraphs 41 to 46 of the new Commentary on Article 1 of the UN Model (2001) which states that "where a tax treaty transfers a company's seat of management. This Commentary notes that it may be difficult to show that the change of residence has been done primarily to obtain treaty benefits where the company is present in the other state for an extended period. It also notes that a proper interpretation of the expression "place of effective management" in Article 5(1) of the UN Model (1969) requires a strong relationship between a company and a country. The mere fact that board meetings take place in a country would not be sufficient to conclude that this is where the company is effectively managed.

5.5.5. Application of treaty based anti-avoidance rules beneficial ownership

The term "beneficial owner" was added to the OECD Model (1977). There is no treaty definition of the term. However, the Commentary on Articles 10 to 12 of the OECD Model has since 1977 explained the term, albeit in a negative way in saying that an intermediary, such as an agent or nominee, that is interposed between the payer and the beneficiary of the income is not the beneficial owner of such income. This idea is repeated in the Commentary (2003). However, the Commentary (2003) noted that it was not a treaty.

It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a State, otherwise through an agent or nominee relationship, acts as a conduit between another person who in fact receives the benefit of the income concerned. The Convention does not normally regard the beneficial owner as "any person having control or dominion and interest in the income or the rights of the owner who is a non-resident" (the beneficial owner definition). This option must also be engaged in "substantial business activities", for example, manufacturing, distribution or management. Conduit entities, which are defined as "entities incorporated for the purpose of the evasion or reduction of tax, the transfer or assimilation of income" (author's unofficial translation). That person must also be engaged in "substantial business activities", for example, manufacturing, distribution or management. Conduit entities, which are defined as "entities incorporated for the purpose of the evasion or reduction of tax, the transfer or assimilation of income" (author's unofficial translation).

One other issue is whether the term "beneficial owner" is a wholly objective one or whether it is a complex construct in accordance with national anti-abuse measures or doctrine as often include a subjective element. For example, in France, the anti-abuse doctrine is based on the principle that the source state must be considered as the beneficial owner of the income. In this regard, those persons under the anti-abuse doctrine are beneficially owned by the source state.

Another controversial issue is whether the term "beneficial owner" is a wholly objective one or whether it is a complex construct in accordance with national anti-abuse measures or doctrine as often include a subjective element. For example, in France, the anti-abuse doctrine is based on the principle that the source state must be considered as the beneficial owner of the income. In this regard, those persons under the anti-abuse doctrine are beneficially owned by the source state. In France, Article 5.4 of the Code des Etats in France, pursuant to the anti-abuse of law doctrine to interpret the term "beneficial owner" as a "person who has the beneficial ownership of the income or income tax. The debate in France is whether the concept of "beneficial owner" is really different from law-abuse and whether the tax authorities have the right to apply the concept of "beneficial owner" beyond cases involving agents and mere nominees. Such questions have not yet been decided by French courts.

6. Conclusions

On very similar facts courts in different jurisdictions (and even within the same jurisdiction) have arrived at diametrically opposite results. This is not a satisfactory outcome. Various arguments appear to explain this situation, including: (1) different perceptions of the facts, (2) different interpretations of anti-abuse methodologies adopted by courts in the various jurisdictions; (3) the different policies of states towards tax avoidance and treaty shopping; (4) different approaches to fundamental questions as to whether tax treaties include an anti-abuse rule and whether domestic GAARs and SAARs can be applied to treaties where the tax treaty does not explicitly allow so, etc.; and (5) the willingness of courts to rely on the OECD and UN Commentary and to apply posterior the Commentary (2003) to earlier tax treaties and/or facts.

Recently, in India, in a case similar to the Case 3 scenario, the question has been raised as to whether the concept of "beneficial ownership" is implicitly present in the capital gains article of India's tax treaties. In this case, a German company in 2004 purchased its wholly owned subsidiary in India and then sold the Indian subsidiary, KGSP Netherlands intended to sell the shares with a capital gain to a non-resident of India.

In that case, article 13(5) of the India-Netherlands Income and Capital Tax Treaty (1988) provides that only the Netherland's taxing authority, and the Indian tax authorities agreed that the beneficial owner of the capital gain should be the German parent of KGSP Netherlands and that, therefore, India could tax the capital gains under the India-Germany Income Tax Treaty (1995), which is different from the India-Netherlands Income and Capital Tax Treaty (1988). The Indian Authority did not accept the argument that the capital gain was a foreign capital gain that would be subject to the provisions of the India-Netherlands treaty.

61. AAR referred, inter alia, to the fact that the Netherlands company was a separate legal entity with its own board of directors and its own management systems and that it made significant investments in India. It also found that the Netherlands company was not a conduit company set up to channel the gains to its German parent. Finally, the panel observed that the UN had recently expressed whether or not it would be useful to extend the concept of "beneficial ownership" to other parts of the treaty: Articles 10 to 20 (2001) were included in articles 10 to 25, but it declined not to do so.

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61. AAR referred, inter alia, to the fact that the Netherlands company was a separate legal entity with its own board of directors and its own management systems and that it made significant investments in India. It also found that the Netherlands company was not a conduit company set up to channel the gains to its German parent. Finally, the panel observed that the UN had recently expressed whether or not it would be useful to extend the concept of "beneficial ownership" to other parts of the treaty: Articles 10 to 20 (2001) were included in articles 10 to 25, but it declined not to do so.

62. In that case, article 13(5) of the India-Netherlands Income and Capital Tax Treaty (1988) provides that only the Netherland's taxing authority, and the Indian tax authorities agreed that the beneficial owner of the capital gain should be the German parent of KGSP Netherlands and that, therefore, India could tax the capital gains under the India-Germany Income Tax Treaty (1995), which is different from the India-Netherlands Income and Capital Tax Treaty (1988). The Indian Authority did not accept the argument that the capital gain was a foreign capital gain that would be subject to the provisions of the India-Netherlands treaty.