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# BEPS Action 6 Treaty Abuse and Good Governance in Tax Matters Curaçao

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A NEW MODEL OF GLOBAL GOVERNANCE IN INTERNATIONAL TAX LAW MAKING

## **DAY 1: BEPS Action 6: Treaty Abuse**

- OECD-BEPS Project
- EU developments: list of non-cooperative jurisdictions and standard of good governance in tax matters
- BEPS Action 6: Terms of reference
- BEPS Action 6 and MLI
- Practical problems application PPT

## **DAY 2: Relationship PPT and domestic GAARs and SAARs and practical cases**

# 1. OECD-BEPS Project and EU

## OECD

BEPS Inclusive Framework 4 Minimum Standards: 124 countries

BEPS MLI: In force as of 1 July 2018: 85 countries.

Curaçao: BEPS Associate committed to the BEPS Inclusive Framework and also signatory of the BEPS MLI

## EU

Curaçao: EU grey list of non-cooperative jurisdictions

2016 EU Communication (COM/2016/024 final) and ECOFIN Council Conclusions (14166/16, FISC 187)

- ❑ Initial criterion: Commitment to the 4 Minimum Standards
- ❑ Future criterion: To receive a positive assessment for the implementation of 4 Minimum Standards.

## 2. EU Standard of good governance in tax matters

- ❑ 2008: Transparency, exchange of information and fair tax competition
  - 2012: Harmful tax and list of non-cooperative jurisdictions
  - 2016: Anti-tax avoidance package: Harmful tax, anti-Base Erosion and Profit Shifting (BEPS) measures and fair economic activity (tax rate/not artificial)
  - 2017: List of non-cooperative jurisdictions for tax purposes
- ❑ 2018: Transparency, exchange of information, fair taxation and BEPS 4 Minimum Standards

## 2. EU Standard of good governance in tax matters

- ❑ For third (non-EU countries) strategic partnership agreement: Legally binding framework for cooperation (e.g. New partnership agreement ACP countries – New Cotonu agreement under negotiation).
- ❑ For third (non-EU countries) a coordinated tax clause that should be included in free trade agreements that the EU concludes with third countries
- ❑ For third (non-EU countries) relevant agreements, without prejudice to their respective competences. Thus trade and strategic partnership but also other areas (aid, cooperation)

*See I.J. Mosquera Valderrama The EU standard of good governance in tax matters for third (non-EU) countries. Intertax (Forthcoming 2019)*

### 3. BEPS Action 6: Terms of Reference

#### May 2017: Minimum Standard

- ❑ Preamble
- ❑ Treaty provision that will take one of the following three forms:
  - PPT (The Netherlands, Curaçao)
  - PPT with either simplified or detailed LOB
  - Detailed LOB with anti-abuse measures to counteract conduit financing

**1<sup>st</sup> Report on compliance by the BEPS Inclusive Framework available in January 2019**



### 3. BEPS Action 6: Mismatches

“Complex menu of options” due to the opt-in; opt-out clauses: PPT (with or without discretionary relief), Detailed LOB, PPT as interim measure, Supplement PPT with simplified LOB

Difficult to manage due to capacity constraints and tax treaty policy choices

Mismatching of choices may result in multiple mini-treaty negotiations

Changes in tax treaty policy e.g. from PPT to simplified LOB with PPT (e.g. some Latin American countries)

Some examples:

- The Netherlands, Curaçao and Singapore PPT with discretionary relief
- Colombia PPT as interim measure but intend to apply PPT with simplified LOB
- Argentina PPT with simplified LOB
- Costa Rica PPT
- Burkina Faso and Cameroon: No option and then?
- Senegal: Reservation to apply PPT if there is main purpose test

## 4. BEPS Action 6 and Treaty Shopping

### Treaty shopping

To obtain treaty benefits which result in reduced taxation, or non-taxation.

- a) To become a resident of a contracting state to obtain treaty benefits that are available under one or more of its tax treaties with other states (less abusive – requires real and economic presence)
  
- b) To access benefits indirectly by means of a legal entity that is resident in the contracting state (more abusive- element of artificiality)
  - Change of residence before disposition of the property in order to obtain a treaty exemption on taxation of capital gains
  - Conduit arrangements whereby a resident of one state directs an investment through a legal entity in a third state in order to obtain treaty benefits under that state's tax treaty with the ultimate source state (*Duff, 623*).

**•Use of tax treaty provisions, GAARs and SAARs**

## 4. BEPS Action 6 and Treaty Shopping

### Treaty shopping defined in BEPS Action 6 Report

*"Treaty shopping cases typically involve persons who are residents of third States attempting to access **indirectly the benefits** of a treaty between two Contracting States"*

### BEPS Action 6 Q & A

*"Treaty shopping" generally refers to arrangements **through which a person who is not a resident of one of the two States** that concluded a tax treaty may attempt to obtain benefits that the treaty grants to residents of these States. These strategies are often implemented by establishing companies in States with desirable tax treaties that are often qualified as "letterboxes" "shell companies" or "conduits" because these companies exist on paper but have no or hardly any substance in reality. It can be addressed through changes to bilateral tax treaties in line with the minimum standard agreed in the context of the BEPS Project. "*

### Abusive and non-abusive treaty shopping (tax planning real substance)

## 5. BEPS Action 6 in MLI: Curaçao

- ❑ Provisional list of expected reservations and notifications.
- ❑ Definitive list at the deposit of the instrument of ratification of the MLI
  
- ❑ To be approved by the Dutch Parliament, and thereafter deposit by the Netherlands on behalf of Curaçao.
  
- ❑ Covered Tax Agreements CTAs: Malta and Norway.
  
- ❑ In principle, commitment in the MLI only to the 4 Minimum Standards due to limited capacity of the tax administration. However, art. 13 applies choice option A (Artificial avoidance p.e. through the specific activity exemptions), and art. 18 applies (application of part VI arbitration). Chooses for 2 years instead of 3 years. (= the Netherlands, reason certainty)

## 5. Curaçao: MLI: Additional text in the preamble

### **Art. 6(1) An additional text in the preamble**

*"Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including treaty shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third states)"*

### **Art. 6(3) In addition a party may choose to include in the preamble**

*"Desiring to further develop their economic relationship and to enhance their co-operation in tax matters"*

**Curaçao introduces text art. 6(1) in CTAs Malta and Norway and chooses to apply Art. 6(3) to both.**

**Relevant for the interpretation of the PPT (objective element).**

## 5. Curaçao: MLI: Introduction of PPT

Art. 7(1) Prevention of Treaty Abuse: Principal Purpose Test  
Curaçao introduces Principal purpose test in CTAs

***" Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement"***

## 6. Practical Problems: PPT

### Article 7(1): 3 Elements PPT

- **Benefit under a Covered Tax Agreement:** Art. 6 to 22, art. 23, and art. 24 of the OECD Treaty. It can also include tax sparing para. 175 Comm. Art. 29 2017 OECD Model) – Benefit (tax deduction, exemption, deferral or refund).
- **Subjective element:** *“if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit”* – **Tax Administration**
- **Objective element:** *“it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement”* - **Taxpayer**

## 6. Practical Problems: Burden of proof

Tax Administration and Taxpayer: Burden of proof.

- Subjective element: **Reasonable** to conclude having regard to all relevant facts and circumstances that “one of the principal purposes...” Use of the word reasonable lower the burden for the tax authority vis-à-vis taxpayer.
- Objective element: **Establish** that granting of a benefit in accordance with the object and purpose of the relevant treaty provisions. Taxpayer must refute clearly and unambiguously

Court a decisive role on whether or not the transaction arrangement satisfied the PPT. If not clear, the benefit of the doubt should go to the taxpayer (V. *Chand 2018*)

## 6. Problems PPT: Subjective element

- ❑ Lower threshold: PPT: One of the principal purposes is a tax benefit. Arbitrary, but reduced if discretionary relief but still MAP will be needed.
- ❑ Medium threshold: GAAR: Main (sole) purpose a tax benefit. GAAR not applicable if economic substance (a minimal business activity, and there are tax and non-tax related motives). e.g. Northern Indiana Public Service Corp. v. Commissioner (115 F3d 506 (7th Cir. 1997))
- ❑ Higher threshold: Wholly artificial transactions or arrangements entered solely for the purpose of avoiding tax. e.g. Cadbury Schweppes CJEU case (see also Webber, 2017)

## 6. Practical Problems: Subjective element

One of the principal purposes vs. main purpose, sole purpose

- e.g. commercial reason and tax reason: PPT applies if “one of the principal purposes” is a tax reason
- However, balance tax purposes vs. genuine commercial/economic objectives. How that this works in practice? See para. 181 Commentary to art. 29 2017 OECD Model
- Large tax benefit in taxation does not mean always application PPT –if in accordance to the object and purpose of the treaty
- PPT discretionary relief (or not) may raise competition among countries since the tax administrations will have a discretionary power

Some scholars: Recommend to choose for artificiality (objective –wholly artificial arrangements) instead of reasonable test (subjective) test. Desirable?



## 6. Practical Problems: Objective element

Two-steps approach: Object and purpose of (i) treaty in general AND (ii) relevant provisions in the treaty? ?

Preamble: art 6(1) only "indirect benefit of residents of 3<sup>rd</sup> jurisdictions" and also in the definition of treaty shopping "indirectly the benefits".  
How to interpret this?

Role of the explanatory memoranda and commentaries in the interpretation of the object and purpose?

Still problems in interpretation of tax treaties create uncertainty (OECD new project). How to deal with this? Is the commentary to art. 29 (Entitlement to benefits) 2017 OECD Model sufficient? Static vs. dynamic ordinary meaning? Context?

## 6. Practical Problems PPT -SAAR

**PPT-SAAR:** (*para. 171 to commentary art. 29 OECD 2017 MC*)

*Lex specialis.* However, PPT wording: Notwithstanding any provisions of a covered tax agreement. Thus, PPT prevails over SAARs.

PPT apply even if beneficial ownership (BO) requirement is satisfied, or if it has passed the LOB tests. LOB does not address all forms of treaty shopping

PPT umbrella clause prevails over

- LOB , BO, SAARs (MLI art. 8(1) and art. 9(1)).

SAAR: Based objective verifiable (often quantitative, safe harbor) parameters

Scholar (Danon). Not acceptable that still PPT can apply to extend the legal consequences provided therein to other situations beyond the scope of the SAAR.

***Result: Uncertainty for taxpayer***



## 6. Practical Problems PPT -GAAR

However, not clear the relationship PPT and domestic GAARs

Provision in the treaty: Use PPT to solve sloppy drafting or bad treaty negotiation?

GAAR in some countries only for sloppy drafting if the outcome was so unlikely that no legislation was introduced to prevent to counter such outcome

GAAR in all cases also in case of sloppy drafting

- Will countries if fail to apply PPT, still use GAAR to deny treaty benefits?
- GAAR only if authorized in the DTT (analysis in accordance to the object and purpose of the treaty)
- GAAR even if not authorized in the treaty (e.g. Argentina), and how the analysis will take place?

## 6. Practical Problems-PPT Interpretation

PPT not easy to interpret in practice

- Leeway to interpretation by the tax administration and tax court (raise competition in the application of the PPT)
- No certainty for taxpayer. Rules should be clear transparent: Availability, clarity, simplicity and reliability
- Repair of sloppy negotiation or drafting of treaty provision that will be also influenced by the title and preamble of the treaty

*"There is every reason to fear that, once the MLI is in force and a large number of countries (including ones with tax authorities that do not have a reputation for predictable interpretation of tax treaties) begin to apply the PPT, this will undermine the whole system of tax treaty benefits" (P. Baker 2017)*

## 7. BEPS Action 6 and MLI: PPT- Discretionary relief

Art. 7(4) Optional provisions: Discretionary relief  
Curaçao chooses to apply art. 7(4) to CTAs

***“Where a benefit under a Covered Tax Agreement is denied to a person under provisions of the Covered Tax Agreement (as it may be modified by this Convention) that deny all or part of the benefits that would otherwise be provided under the Covered Tax Agreement where the principal purpose or one of the principal purposes of any arrangement or transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits, the competent authority of the Contracting Jurisdiction that would otherwise have granted this benefit shall nevertheless treat that person as being entitled to this benefit, or to different benefits with respect to a specific item of income or capital, if such competent authority, upon request from that person and after consideration of the relevant facts and circumstances, determines that such benefits would have been granted to that person in the absence of the transaction or arrangement. The competent authority of the Contracting Jurisdiction to which a request has been made under this paragraph by a resident of the other Contracting Jurisdiction shall consult with the competent authority of that other Contracting Jurisdiction before rejecting the request”***

## 7. Problems: PPT- Discretionary relief

- a) These benefits would have been granted to **the same person** in the absence of the transaction or arrangement
- Problem: Not possible to grant treaty benefits to another (different) person.
  - Suggested: To change the same person for any person. To grant benefits regardless of the person to whom the benefits would have been granted. Para. 186 Commentary to art. 29 2017 OECD Model
- b) Discretion to competent authority and the other competent authority to be consulted before rejecting the request (burdensome- since it does not require approval only consultation but creates delays) See para. 185 Commentary to art. 29 2017 OECD Model.
- c) Source state: Discretionary relief: Benefit 0% (denied), treaty benefit 15%? OR domestic law 25%? (*V. Chand, 2018*)
- d) Residence state: To credit the additional tax that must be paid in the source state? (*D. Duff 2019*)

## 7. Problems: PPT- Discretionary relief

- Art. 7(4) No a minimum standard. Approx. 27 countries have chosen art. 7(4).
- However, if not art. 7(4) can the tax treaty benefit still be granted especially if such benefits are available under domestic law mechanisms? (US treasury regulations 1.881-3 Conduit Financing Arrangements) For instance following the recharacterization of the transaction? (*V. Chand 2018*).

Important for intermediary companies to provide sufficient non-tax reasons and economic substance for being located in a particular jurisdiction (including appropriate documentation). However, the facts and circumstances of the case will still determined the application of the PPT. *V. Chand 2018*).

## 8. Conclusions -Recommendations

- What happens with countries non- participants of the BEPS inclusive framework and/or MLI?
- Complexity of options: Therefore, consolidation version of tax treaties is desirable, but what if the version binds the tax administration? Less of two evils?
- PPT not easy to interpret in practice
- Leeway to interpretation by the tax administration and tax court.
- No certainty for taxpayer. Rules should be clear transparent: Availability, clarity, simplicity and reliability
- Repair of sloppy negotiation or drafting of treaty provision that will be also influenced by the title and preamble of the treaty
- Would have been useful to use the test of artificiality (objective) instead of the reasonable test (subjective)?



## 8. Conclusions - Recommendations

International tax standards have changed through BEPS, but not yet clear how these new standards will benefit developing countries?

more uncertainty and compliance cost for companies

tax competition for developing and developed countries vis-à-vis countries not implementing the BEPS minimum standards (inclusive framework 124, MLI 85, 193 countries/jurisdictions in the world)

Research on the differences in the implementation of the minimum standards is needed.

See GLOBTAXGOV project 12 countries research.

***EU-ERC funded research project (2018-2023): GLOBTAXGOV: A New Model of Global Governance in International Tax Law Making***





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# Day 2: PPT, GAARs and SAARs

## Practical cases

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# 1. Relationship PPT and domestic GAARs and SAARs

## ***Belastingregeling (BRK) Nederland – Curaçao 30 september 2015***

- *Artikel 22 Anti-misbruik: Toepassing instrument ter bestrijding van fraude, misbruik en oneigenlijk gebruik*
- *Niet van toepassing artikel 17(3), onderdeel b, Vpb 1969 (voorwaarden)*

## ***Nota naar aanleiding van het verslag 5 juli 2018***

*Waarom Curaçao slechts voor de minimumstandaarden heeft gekozen?*

- *Curaçao, Aruba, Sint Maarten. Autonomie gebied van belastingen*
- *Curaçao – minimumstandaarden – beperkte capaciteit.*
- *BRK Rijkswet, dus niet onder BEPS. Bevat ook antimisbruik bepalingen. Maar in toekomst aanpassen: anti-misbruik bepaling BEPS. Dus PPT? En ook optie Verdrag artikel 6(4)?*

## 1. Relationship PPT and domestic GAARs and SAARs

*NOB brief 1 maart 2018 (blz. 4)*

- Kan de praktijk er van uitgaan (i) dat de Nederland ook onder het Verdrag de toets van een kunstmatige constructie zal hanteren en (ii) dat voor de invulling van deze nationale anti-misbruikbepaling gebruikte substance- eisen ook zullen gelden voor de toepassing van de PPT onder het Verdrag en (iii) dat zij ook zullen worden gebruikt indien een bronland met de PPT in de hand de voordelen van het bilaterale belastingverdrag niet wil toekennen?*
- Is het cabinet voornemens memoranda of understanding met belangrijke verdragspartners te gaan sluiten waarin safe-harbours voor de toepassing van de PPT worden afgesproken?*

## 2. Treaty abuse and PPT practical cases

Two cases:

1. Northern Indiana Public Service Corp. v. Commissioner (115 F3d 506 (7<sup>th</sup> Cir. 1997))

<https://law.resource.org/pub/us/case/reporter/F3/115/115.F3d.506.96-1758.96-1659.html>

Court concluded that the arrangement had economic substance

2. AmBase Corporation v. Commissioner (Docket No. 11816-95 (US Tax Court 2001))

<https://www.courtlistener.com/opinion/4556033/ambase-corporation-fka-the-home-group-inc-v-commissioner/>

No application of the domestic GAARs but instead the principles of the IRS rulings

## 2. Treaty abuse and PPT practical cases

In these cases, the courts declined to apply domestic GAARs and SAARs rules.

Will the outcomes of these cases still be the same under PPT?

### 3. Covered Tax Agreement Curaçao - Malta

Position Curaçao: Pending ratification

<http://www.oecd.org/tax/treaties/beps-mli-position-curacao.pdf>

Position Malta: Instrument for ratification MLI deposited 18 December 2018. In force as of 1 April 2019

<http://www.oecd.org/tax/treaties/beps-mli-position-malta-instrument-deposit.pdf>

## Further reading

- V. Chand, The principal purpose test in the Multilateral Convention. An in-depth analysis. 46 Intertax Issue 1 (2018) pp. 18-44
- D. Duff, Tax Treaty Abuse and the Principal Purpose Test Part I. Canadian Tax Journal (2018) pp. 619-677
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- I.J. Mosquera Valderrama The EU standard of good governance in tax matters for third (non-EU) countries. Intertax (Forthcoming 2019)
- D. Weber, "The Reasonableness Test of the Principal Purpose Test Rule in OECD BEPS Action 6 (Tax Treaty Abuse) versus the EU Principle of Legal Certainty and the EU Abuse of Law Case Law", Erasmus Law Review, 1, (2017) pp. 48-59



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